Supreme Court, U. S.
FILED
OCT 24 1975
MICHAEL RODAK, JR., CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1975

No. 75-6191

ROBERT A. MANN AND BANK OF THE SOUTHWEST, NATIONAL ASSOCIATION,
Petitioners

v.

UNITED STATES OF AMERICA,
Respondent

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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Bowne of Houston, Inc. Printed in U.S.A.

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I. The decision of the Court of Appeals conflicts with the applicable principles established by this Court in that the Court of Appeals erred in failing to affirm the holding of the trial court that:

A. The indictment, as clarified by the Bill of Particulars, failed to state the offense of conspiracy under 18 U.S.C. § 371 to willfully misapply funds of a national bank as prohibited by 18 U.S.C. § 656. 15

B. This prosecution deprives Petitioners of due process of law because the Petitioners did not have prior notice that the acts charged were criminal acts 18

II. The Court of Appeals decided an important question of law which has not been, but should be, settled by this Court because this case involves the nation's entire national banking industry and is a case of first impression in this court. The indictment presents allegations of fact not heretofore believed by the banking industry to constitute a crime, nor expressly prohibited by any statute or regulation, and involving a practice which the Department of Justice concedes to be common and widespread. In addition, the transaction for which Petitioners have been indicted as constituting a willful misapplication of bank

funds within the meaning of 18 U.S.C. § 656 has been treated inconsistently by the Comptroller of the Currency and the Department of Justice, causing widespread confusion in the banking industry, and is of a type which is still being sanctioned by the Federal Reserve Board 23

III. The Court of Appeals, in its decision, has so far departed from the accepted and usual course of judicial proceedings as to call for this Court's power of supervision. The Court of Appeals held that at a Rule 12 hearing on Motion to Dismiss, the defenses of lack of fair notice to the Petitioners and of violation of Petitioners' constitutional rights of due process were not capable of determination based on undisputed evidence without trial of the general issue 26

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ROBERT A. MANN AND BANK OF THE SOUTHWEST, NATIONAL ASSOCIATION,
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v.

UNITED STATES OF AMERICA,
Respondent

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

ROBERT A. MANN and BANK OF THE SOUTHWEST NATIONAL ASSOCIATION, (referred to herein as Petitioners) petition the Court to grant and issue a Writ of Certiorari to review the judgment entered in this criminal case by the United States Court of Appeals for the Fifth Circuit on August 7, 1975. This case involves the legality of a common banking practice known as a "compensating balance" loan, and is a case of first impression.

OPINIONS OF THE COURTS BELOW

The opinion delivered in the Court of Appeals upon the rendering of the judgment sought to be reviewed appears in Appendix A (unreported at this time). The unreported Memorandum Opinion delivered in the District Court appears in Appendix B.

JURISDICTION OF THE SUPREME COURT

The Court of Appeals' judgment was entered on August 7, 1975. The Petitioners' timely Petition for Rehearing was denied on September 25, 1975. Title 28 United States Code, § 1254(1), and U.S. Sup. Ct. R. 22(2) confer on this Court jurisdiction to review the judgment in question in this important criminal case by Writ of Certiorari.

QUESTIONS PRESENTED FOR REVIEW

1. Whether this criminal indictment, clarified by the Bill of Particulars, which alleges that the object of the conspiracy was to be accomplished by an agreement between Petitioners to cause funds of the First National Bank of Waco to be deposited in and to remain on deposit in the demand account of the First National Bank of Waco at Bank of the Southwest, as a condition to the making of a secured loan by Bank of the Southwest to Robert Mann at a low rate of interest, is sufficient to state the offense of conspiracy to willfully misapply funds of the First National Bank of Waco (conspiracy under 18 U.S.C. § 371 to violate 18 U.S.C. § 656).

2. Whether the indictment, clarified by the Bill of Particulars, which alleges facts that do not constitute a misapplication of funds under 18 U.S.C. § 656, will be held sufficient to state an offense merely because it contains a legal conclusion, inconsistent with the well-pled facts contained in the indictment and Bill of Particulars, that monies were to be "willfully misapplied."

3. Whether prosecution of this case would deprive Petitioners of due process of law because of lack of fair notice that the acts with which they are charged were prohibited by law, where, as here, (a) there is complete silence in the statute [18 U.S.C. § 656] and in its legislative history in regard to utilizing correspondent accounts as compensating balances for loans to bank officers being a criminal act; (b) Petitioners had no notice that such conduct was criminal; (c) such loan practice was common and widespread in the highly regulated banking history; (d) there had been no prior prosecutions; and (e) the Government had made public statements that were both confusing and misleading.

4. Whether the Court of Appeals erred in holding that Petitioners were precluded from offering evidence at the Rule 12 hearing on Motion to Dismiss to prove lack of fair notice to Petitioners that the conduct with which they were charged was criminal and to prove a violation of Petitioners' constitutional right of due process, which defenses related to defects in the institution of the proceedings and were capable of determination without trial of the general issue.

CONSTITUTIONAL PROVISIONS, STATUTES AND REGULATIONS INVOLVED

Constitution

Constitution of the United States, Fifth Amendment

Statutes

12 U.S.C. § 371a
18 U.S.C. § 371
18 U.S.C. § 656

Federal Rules of Criminal Procedure

Rule 12

Regulations or Directives

Office of the Comptroller of the Currency, Banking Circular No. 31, October 22, 1970.

All of the above are set forth in Appendix C.

STATEMENT OF THE CASE

A. Course of Proceedings

On June 18, 1973, a federal grand jury in Houston, Texas, returned a one count indictment [R. 3] charging that ROBERT A. MANN ["MANN"] and BANK OF THE SOUTHWEST, NATIONAL ASSOCIATION ["BSW"], of Houston, Texas, the Petitioners, committed an offense against the United States by violating the general conspiracy statute, 18 U.S.C. § 371. The basis of the District Court's jurisdiction is 18 U.S.C. § 3231.

By Bill of Particulars [R. 13], the non-interest bearing account referred to in the indictment was identified as the demand deposit account of the First National Bank of Waco at BANK OF THE SOUTHWEST. The Bill of Particulars further clarified the indictment by stating that the only account into which it was charged that monies of the First National Bank of Waco were placed was this demand account.[1]

[1] Having identified the account into which it is charged that the funds of the First National Bank of Waco were deposited and remained as the demand account of the Waco bank at the Bank of the Southwest in the Bill of Particulars, the scope of the Government's proof at trial is strictly limited to the particulars which it has specified. *United States* v. *Haskins*, 345 F.2d 111 (5th Cir. 1965); *United States* v. *DePugh*, 266 F.Supp. 417, 435 (W. D. Mo. 1967); *United States* v. *Murray*, 297 F.2d 812 (2d Cir. 1962), cert. denied 369 U.S. 828, 7 L.Ed.2d 794. Accordingly, in determining the sufficiency of the indictment in each instance in which reference is made to a "non-interest bearing account", the indictment should be read as if it charged that the account in question was the demand account of the Waco bank at Bank of the Southwest.

The Government charged that the Petitioners' object of the conspiracy was the commission of an offense in violation of the *misapplication of bank funds statute,* 18 U.S.C. § 656.[2]

[2] In the indictment, the Grand Jury charged (as clarified by the Bill of Particulars in brackets):

> Beginning on, or about, December 9, 1969, and continuing to on, or about, February 28, 1972, within the Houston Division of the Southern District of Texas, defendants, ROBERT A. MANN, Chairman of the Board of Directors and Chief Executive Officer of First National Bank of Waco, Waco, Texas and BANK OF THE SOUTHWEST, NATIONAL ASSOCIATION, Houston, Texas, and unindicted co-conspirator, Weyman W. Horadam, Senior Vice-President of Bank of the Southwest, National Association, Houston, Texas, and divers other persons whose names are to the Grand jury unknown, combined, conspired, agreed and confederated to commit an offense against the laws of the United States, to-wit: to knowingly and willfully misapply monies and funds of the First National Bank of Waco, a national bank and a member bank, with intent to injure and defraud said bank by causing said monies and funds to be converted to the use, benefit and advantage of the defendant, ROBERT A. MANN, in violation of Title 18, United States Code, Section 656.
>
> The object of the conspiracy was to be accomplished as follows:
>
> The defendant, ROBERT A. MANN, was to acquire controlling interest in the stock of First National Bank of Waco for the purchase price of approximately $6,900,000.00.
>
> To finance the purchase of the aforesaid stock, the defendant, ROBERT A. MANN, was to borrow $6,900,000.00 from the defendant, BANK OF THE SOUTHWEST.
>
> Unindicted co-conspirator Weyman W. Horadam was to act as an officer and agent of defendant, BANK OF THE SOUTHWEST, and was to arrange for the defendant, BANK OF THE

SOUTHWEST, to lend $6,900,000.00 to the defendant, ROBERT A. MANN.

The defendant, BANK OF THE SOUTHWEST, was to extend credit and fund the aforesaid $6,900,000.00 loan to the defendant, ROBERT A. MANN, at the rate of interest of three per cent (3%) per annum notwithstanding the fact that the prime rate of interest per annum charged by the defendant, BANK OF THE SOUTHWEST, at such time was eight and one-half per cent (8½%).

The defendant, BANK OF THE SOUTHWEST, was to sell a participation of $2,900,000.00 of the loan to the defendant, ROBERT A. MANN, to Republic National Bank, Dallas, Texas, thereby rendering defendant, BANK OF THE SOUTHWEST's, extension of credit and funding of the aforesaid loan to the defendant, ROBERT A. MANN, $4,000,000.00.

To compensate the defendant, BANK OF THE SOUTHWEST, for extending and funding the aforesaid $4,000,000.00 loan to the defendant, ROBERT A. MANN, at the preferential rate of interest of three per cent (3%) per annum, the defendant, BANK OF THE SOUTHWEST, was to require the defendant, ROBERT A. MANN, to place on deposit with defendant, BANK OF THE SOUTHWEST, an amount of money commensurate with the principal amount of the loan, to-wit: $4,000,000.00, which money was to be placed in a non-interest bearing account [the demand account of the Waco bank] until such time as the said $4,000,000.00 principal was reduced or was paid in full.

The defendant, ROBERT A. MANN, *was to cause* $4,000,000.00 of monies and funds of the First National Bank of Waco to be placed on deposit in the aforesaid non-interest bearing account [the demand account of the Waco bank] at the defendant, BANK OF THE SOUTHWEST, whereby *the use, benefit and advantage* of said monies and funds was converted from the First National Bank of Waco to the use, benefit and advantage of the defendant, ROBERT A. MANN.

By reason of the aforesaid $4,000,000.00 to be placed on deposit in a non-interest bearing account [the demand account of the Waco bank] at the defendant, BANK OF THE SOUTHWEST, the defendant, ROBERT A. MANN, was to receive the preferential rate of interest on the aforesaid loan of three per cent (3%) per annum, thereby saving the defendant, ROBERT A. MANN, approximately $[illegible]50,000.00 per year in interest charges.

The defendants, ROBERT A. MANN and BANK OF THE SOUTHWEST, were to agree that if the $4,000,000.00 principal was reduced, but not paid in full, by the defendant, ROBERT A. MANN, then, in such event, the amount of money required to be kept by the defendant, ROBERT A. MANN, in the non-interest bearing account [the demand account of the Waco

bank] at the defendant, BANK OF THE SOUTHWEST, would be reduced by an amount commensurate with said reduction in the principal.

The defendant, ROBERT A. MANN, *was to cause* the principal amount of the aforesaid loan to be reduced from $4,000,000.00 to $3,000,000.00, at which time the defendant, BANK OF THE SOUTHWEST, was to cause the rate of interest charged per annum on said loan to be increased from three per cent (3%) to four per cent (4%), notwithstanding the fact that the prime rate of interest charged by the defendant, BANK OF THE SOUTHWEST, at such time was six per cent (6%) per annum.

The defendant, BANK OF THE SOUTHWEST, was to further permit the defendant, ROBERT A. MANN, to reduce the amount of money required to be kept on deposit in the aforesaid non-interest bearing account [the demand account of the Waco bank] at the defendant, BANK OF THE SOUTHWEST, from $4,000,000.00 to $3,000,000.00.

The defendant, ROBERT A. MANN, was to cause $1,000,000.00 of the $4,000,000.00 of monies and funds of the First National Bank of Waco, Waco, Texas, then and there on deposit with the defendant, BANK OF THE SOUTHWEST, to be withdrawn therefrom and *was to cause* the remaining $3,000,000.00 of monies and funds of the First National Bank of Waco, Waco, Texas to continue to remain on deposit in the aforesaid non-interest bearing account [the demand account of the Waco bank] at the defendant, BANK OF THE SOUTHWEST, whereby *the use, benefit and advantage* of said monies and funds were converted from the First National Bank of Waco, Waco, Texas, to the use, benefit and advantage of the defendant, ROBERT A. MANN.

By reason of the aforesaid $3,000,000.00 continuing to remain on deposit in a non-interest bearing account [the demand account of the Waco bank] at the defendant, BANK OF THE SOUTHWEST, the defendant, ROBERT A. MANN, was to receive the preferential rate of interest on the aforesaid loan of four per cent (4%) per annum, thereby saving the defendant, ROBERT A. MANN, approximately $110,000.00 per year in interest charges.

During the existence of the aforesaid loan, the defendant, BANK OF THE SOUTHWEST, was to receive a constant return on the loan made to the defendant, ROBERT A. MANN, at the rate of approximately seven and one-quarter per cent (7¼%) per annum notwithstanding the increase in the rate of interest charged from three per cent (3%) per annum to four per cent (4%) per annum and notwithstanding the decrease in the amount of money required of the defendant, ROBERT A. MANN, to be kept on deposit at the defend-

The Petitioners, pursuant to Fed.R.Crim.P. 12, moved the District Court to dismiss the indictment [R. 15, 27, 83]. The Amended Motion to Dismiss asserted that: (A) the conspiracy charged as criminal conduct had never been declared to be a violation of any law, particularly 18 U.S.C. §656 or 18 U.S.C. §371; (B) the Department of Justice, on October 22, 1970, had for the first time unlawfully attempted to proscribe the alleged conduct *after* the loan had already been made in December, 1969; and (C) that regardless of the first two assertions above, the alleged conduct was not, as a matter of law, a violation of either 18 U.S.C. §656 or 18 U.S.C. §371 because the transfer of bank funds from the First National Bank of Waco to its correspondent bank account at Petitioner BANK OF THE SOUTHWEST in Houston, did not constitute a criminal misapplication of such transferred funds by Petitioner, ROBERT A. MANN.

---

ant, BANK OF THE SOUTHWEST, from $4,000,000.00 to $3,000,000.00.

To effect the object of the conspiracy and in furtherance thereof, the defendants, ROBERT A. MANN and BANK OF THE SOUTHWEST, and unindicted co-conspirator Weyman W. Horadam committed divers overt acts, among which are the following:

1. On, or about, December 12, 1969, defendant, ROBERT A. MANN and unindicted co-conspirator Weyman W. Horadam had a meeting in Houston, Texas.

2. On, or about, December 12, 1969, defendant, BANK OF THE SOUTHWEST, made a loan to defendant, ROBERT A. MANN.

3. On, or about, June 11, 1970, defendant, BANK OF THE SOUTHWEST, renewed the aforesaid loan to defendant, ROBERT A. MANN.

4. On, or about, January 15, 1971, defendant, BANK OF THE SOUTHWEST, renewed the aforesaid loan to defendant, ROBERT A. MANN.

5. On, or about, July 28, 1971, defendant, BANK OF THE SOUTHWEST, renewed the aforesaid loan to defendant, ROBERT A. MANN.

6. On, or about, August 26, 1971, defendant, BANK OF THE SOUTHWEST, renewed the aforesaid loan to defendant, ROBERT A. MANN.

(Violation: Title 18, United States Code, Section 371) [Italics added.]

On July 23, 1974, the District Court, after an extensive hearing [R. 193], rendered a judgment dismissing the indictment on eight grounds, *inter alia,* that the indictment failed to charge an offense; that the Petitioners had been deprived of due process of law because 18 U.S.C. §656 *as applied* in this case is too vague and indefinite to sustain a criminal prosecution; that this prosecution constituted an ex post facto application of law; and that the manner in which the Government had attempted to prosecute the Petitioners denied them due process of law. [App. B at B-1].

The Government, pursuant to the Criminal Appeals Act, 18 U.S.C. §3731, then appealed to the United States Court of Appeals for the Fifth Circuit to reverse the District Court's judgment. The Court of Appeals reversed the District Court's judgment on all eight grounds [App. A]. It is the Court of Appeals' judgment that Petitioners ask this Court to review.

B. Background of Proceedings

The record reveals the absence of any federal statute or regulation that has ever placed a prohibition on "compensating balance" loan practices until the Comptroller of the Currency issued Circular No. 31 on October 22, 1970 [App. C at C-6].

The Government charged in the indictment that, in connection with BSW's loan to MANN, MANN "was to cause the acquired Waco bank to place additional funds on deposit with the Houston bank into the Waco bank's *regular demand deposit account* at or near the time that MANN made his loan, and that the transfer of such funds by the Waco bank to its Houston correspondent bank would constitute a criminal misapplication of such funds *by MANN*. According to the Government, the Waco bank would thus be deprived of the "use, benefit, and advantage"

of these funds *by MANN*[3]; even though the Government admitted in its Bill of Particulars and on oral argument that such transferred funds were to be placed in the Waco bank's regular correspondent demand deposit account at the Houston bank [R. 13, 296, 297, 298, 308].

At the time the loan was made in December, 1969, well-established banking rules and regulations existed; but none of these rules and regulations notified the Petitioners that such admittedly common and widespread "compensating balance" loan practices were or could conceivably be argued to be a violation of a criminal statute.

Nonetheless, the Government returned the indictment in this, the first case in the nation's banking history in which individuals were so indicted, and which represents the Government's initial effort to create a crime pursuant to the elements set forth in Circular No. 31.

There seems little doubt of the vital significance of this case and the desperate need for review.

This test case stands in sharp contrast to the background preceding the indictment. The record clearly reveals:

(1) *The long course of common and almost universal practice in the banking industry of transacting such loans.*

The most exhaustive article on the subject of compensating balances is found in an excellent discussion in Virginia Law Review. The article states in part:

> "The significance of compensating balance requirements derives, in part, from their widespread use in this country. Studies conducted by Robert Morris Associates in 1954 and in 1958 indicate that over two-thirds of the nation's largest banks imposed compensating balance requirements for the extension of credit lines, while over half imposed the requirement on specific loans. A 1964 survey of five hundred banks throughout the country confirmed the prevalence of the arrangement. . . Additional studies, and a substantial body of literature, support the conclusion that the compensating balance convention is an *entrenched* practice in the banking industry." Austin and Solomon, *The Antitrust Implications of Compensating Balances,* 58 VA. L. REV. 1, 3 (1972) [emphasis added].

[3] The Court of Appeals ignored Petitioners contention that the indictment is defective on its face in that it includes language not contained in 18 U.S.C. § 656. The statute makes criminal the willful misapplication of "monies, funds and credits". In its allegation of the manner in which the object of the conspiracy was to be accomplished, the indictment alleges "whereby *the use, benefit and advantage of said monies and funds* were converted". It is not charged that the monies, funds or credits were themselves converted. Use of the italicized words in the indictment cannot be supported by the statute nor by any cases interpreting the statute [emphasis added].

There is no dispute that the practice is common and widespread. In the fall of 1970, Assistant Attorney General Richard W. McLaren, Antitrust Division of the Justice Department, wrote a letter to Congress in which he urged that "compensating balance" loans not be outlawed under the 1970 amendments to the Bank Holding Company Act [12 U.S.C. § 1972 (1970)]:

> "However, since then, it has been brought to our attention that the [proposed] language contained in Section 104(b) [now Title I, Section 106(b), Pub. L. 91-607, Dec. 31, 1970, 84 Stat. 1766] may cover a variety of traditional banking arrangements on which the Committee has received no testimony or other evidence. These include the traditional practices of a bank's asking its loan customers to maintain compensating balances as partial compensation for a loan, and calling upon correspondent banks to maintain correspondent balances as compensation for services. Section 104(b) may also reach various traditional loan agreement restrictions which are based on credit considerations (e.g., prohibitions on additional borrowing). *Since these practices are almost universal and may serve necessary banking functions, we believe they should not be outlawed, or placed in doubt, without careful prior study.*" 116 Cong. Rec. 32125 and 32126. (1970) (emphasis added.)

During this same period, in the fall of 1970, Assistant Attorney General Will Wilson, Criminal Division of the Justice Department, directed the Comptroller of the Currency, to notify all national banks on October 22, 1970, through Circular No. 31, *for the first time* that "compensating balances" "might be" a violation of 18 U.S.C. § 656, *"no cases"* at that time so held. As quoted in Circular 31, Wilson specifically noted that the loan practice was "fairly widespread" [R. 961] [emphasis added.]

Thus, in the fall of 1970, two major divisions of the Justice Department recognized that this loan practice was "traditional" and "fairly widespread," but took divergent and confusing views in public statements. The Antitrust Division was stating the practice ". . . may serve necessary banking functions . . ." and should not be outlawed or placed in doubt without careful study, while at the same time the Criminal Division was telling the same banking industry that such practices might be a violation of law.

(2) *The banking industry's lack of prior notice that such "compensating balance" type loans were or could reasonably be construed to be a violation of any criminal statute, and the widespread confusion and concern which still exists in the industry today.*

The record is devoid of any public notice whatsoever by any government agency that the loan in question might even be considered a violation of any criminal statute until October 22, 1970, when Circular No. 31 was issued, ten (10) months *after* the loan here was made in December, 1969.

The Comptroller of the Currency commented upon the lack-of-fair-notice aspect of the case in advising the Department of Justice on March 21, 1973 that he did not believe the case warranted federal prosecution [R. 943-944]. The Comptroller stated in part in this letter:

> "Against this background and *considering the date on which the Mann loan was made,* it does not appear either possible or fair to charge Mr. Mann or the Bank of the Southwest or the First National Bank of Waco with a willful violation." [R. 944] (emphasis added)[4]

Even prior to Camp's letter, the Justice Department circulated internal memoranda evidencing its own doubts about the fair notice aspect of prosecuting "compensating balance" cases. For example, on May 4, 1971, John C. Keeney, Chief, Fraud Section, wrote a letter to the United States Attorney in Houston, Texas, stating in part:

> "Although we are satisfied that, in some instances, this practice clearly evinces a misuse of the funds and credits of a bank, it is believed that the prevalence of the practice and the failure of the regulatory agencies to curtail the activity, will make it difficult to predicate a prosecution on conduct occurring *before* the above dates. A defense of good faith and common practice, would substantially negate criminal intent. For this reason a prosecution charging misuse of correspondent accounts occurring *prior to the date of the directives* [October 22, 1970] *would be impractical. Accordingly, it is our view that the dates of the directives* [October 22, 1970] *putting the banks on notice of possible criminality in these transactions should generally be the cut-off date for prosecution purposes."* [R. 847-848] (emphasis added)

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[4] Petitioners urge this Court to read two sealed letters in the record, which Petitioners have not seen. One letter is from the United States Attorney in Houston to the Assistant Attorney General, Criminal Division, Department of Justice, dated ..... and the reply from the Assistant Attorney General to the United States Attorney in Houston dated ..... The Government tendered these sealed letters to the trial judge, who read them and ordered them resealed and placed in evidence [R. 198-199]. Petitioners do not know if the Court of Appeals read the letters or not, but apparently they relate to reasons why this particular case should or should not have been prosecuted under the Circular No. 31 directive.

The United States Attorney in Houston, after receiving Keeney's letter of May 4, 1971, conducted a very unusual meeting on May 14, 1971 with various national bank executives in Houston *to explain the new government prosecution policy* under Circular No. 31 to them [R. 849-858].

The confusion concerning the legality of "compensating balance" loans still exists today. As the Comptroller of the Currency declared on March 21, 1973:

> "The fact is that *none* of the attempts at clarification in this grey area have been successful and as of today bankers still are not sure of the circumstances under which they safely can maintain on their books simultaneously a deposit from a correspondent bank and a loan to a principal of that bank even though such a combination is a common and natural occurrence in many completely legitimate and routine situations." [R. 843, at 844]

In fact, the Board of Governors of the Federal Reserve System has approved three of such loans by approving bank holding company applications even *after* the indictment was returned in this case [Appendix D at D-1 through D-11].

Therefore, the background of these proceedings presents a course of sudden change in government policy, an attempted retroactive application of that policy, a refusal of the then Comptroller to refer the case for prosecution, and, indeed, and most importantly, a confused and bewildered industry including Petitioners that, to this good day, can go to its government seeking review of its lending practices and, on one hand, may get approval from the Federal Reserve System or, on the other, a referral for prosecution from the present Comptroller. These events defeat the Government's basis for this indictment.

REASONS RELIED ON FOR THE ALLOWANCE OF THE WRIT

I. THE DECISION OF THE COURT OF APPEALS CONFLICTS WITH THE APPLICABLE PRINCIPLES ESTABLISHED BY THIS COURT IN THAT THE COURT OF APPEALS ERRED IN FAILING TO AFFIRM THE HOLDING OF THE TRIAL COURT THAT:

A. The Indictment, as clarified by the Bill of Particulars, fails to state the offense of conspiracy under 18 U.S.C. § 371 to willfully misapply funds of a national bank as prohibited by 18 U.S.C. § 656.

Argument

The indictment purports to charge a conspiracy to violate 18 U.S.C., Section 656. However, when the indictment is read together with the clarification made by the Bill of Particulars, it becomes crystal clear that what it is charged that the Petitioners agreed to do was not unlawful. The agreement Petitioners are alleged to have made does not constitute a criminal misapplication of funds of the Waco bank.

The holding of the Court of Appeals is in direct conflict with the decisions made and the principles established by the Supreme Court in *United States* v. *Britton,* 107 U.S. 655, 2 S.Ct. 512, 27 L.Ed. 520, (1883); *United States* v. *Britton,* 108 U.S. 193, 2 S.Ct. 526, 27 L.Ed. 701 (1883); *United States* v. *Northway,* 120 U.S. 327, 7 S.Ct. 580, 30 L.Ed. 664 (1887); and *United States* v. *Heinz,* 218 U.S. 532, 31 S.Ct. 98, 54 L.Ed. 1139 (1910).

This Court has held that to constitute an offense of willful misapplication there must be an actual conversion of a bank's funds and the indictment must aver such a conversion.

In the first *Britton* decision *supra,* this court said:

> "We think the willful misapplication made an offense by this statute [Rev.Stat. § 5209] means a misapplication for the use, benefit, or gain of the party charged,

> or of some company or person other than the [bank]. Therefore, to constitute the offense of willful misapplication, there must be a *conversion* to his own use or the use of some one else of the moneys and funds of the [bank] by the party charged. This [is an] essential element of the offense..." 2 S.Ct. at 522 (emphasis added.)

In *United States* v. *Northway, supra,* this Court cited the *Britton* case as holding that:

> "...it was held to be of the essence of the criminality of the misapplication that there should be a conversion of the funds to the use of defendant, or of some other person other than the [bank], with intent to injure or to defraud the [bank] . . ." 7 S.Ct. at 583.

In the later case of *United States* v. *Heinz, supra,* the foregoing cases were cited with approval, and the Court stated:

> "These cases establish that there must be, to constitute a misapplication of the funds of the bank, a conversion . . ." 31 S.Ct. at 101.

This Court has never deviated from the rule that to constitute a willful misapplication there must be an actual conversion of a bank's funds.[5]

The indictment, as clarified, alleges that the object of the conspiracy was to be accomplished by Petitioners' agreement "to cause" funds of the First National Bank of Waco to be deposited in and to remain on deposit in the demand account of the First National Bank of Waco at BANK OF THE SOUTHWEST as a condition to the making of a secured loan by the BANK OF THE SOUTHWEST to ROBERT MANN at a low rate of interest.

As a matter of law, no conversion of funds by Petitioner's of the Waco bank could have occurred. The monies

[5] Congressional revision of the statutory provisions now codified as 18 U.S.C. § 656 has made no attempt to change this settled interpretation.

in the bank's own demand account were never lost to or beyond the control of the Waco bank. *Britton, Northway,* and *Heinz* (*supra,* p. 15)

By statute [12 U.S.C. 371a], all such demand accounts are required to be non-interest bearing; consequently, the BANK OF THE SOUTHWEST could not pay interest on the Waco bank's demand account, and the funds in the demand account were legally subject to the Waco bank's withdrawal.[6]

Clearly, the words "willfully misapplies" as used in § 656 mean a criminal misapplication rather than a mere act of maladministration. *United States* v. *Britton, supra.* Also, the words "willfully misapplies" have no settled technical meaning like the word "embezzle" or the words "steal", "take", and "carry away", as used at common law. They do not, therefore, of themselves fully and clearly set forth every element of the offense charged. For this reason, it is not sufficient simply to aver that Petitioner "willfully misapplied" the funds of a bank. There must be averments to show how the misapplication was made and that it was an unlawful one. *United States* v. *Britton, supra,* 2 S.Ct. at 524.

Furthermore, this indictment, clarified by the Bill of Particulars, cannot be held sufficient to state an offense merely because it contains legal conclusions of "misapplication" by Petitioners, which conclusions are inconsistent with the well-pled facts. The well-pled facts of the indictment reveal that the Waco bank was to be caused to place its own funds in its own bank account at BSW. Therefore, the mere legal conclusion that such acts were to constitute "misapplication" cannot save the defect in the indictment.

[6] The duty owed by a bank to its depositor is to pay upon demand. *United States* v. *Guaranty Trust Co. of New York,* 100 F.2d 369, (2d Cir., 1938), at p. 371. See also *Anderson National Bank* v. *Luckett,* 321 U.S. 233, 64 S.Ct. 599, 88 L.Ed.2d 692 (1944), 64 S.Ct. at p. 607.

The Court of Appeals has erred in so holding and in so doing is in conflict with the decision of that court in *United States* v. *Strauss,* 283 F.2d 155, 158 n. 6 (5th Cir. 1960), as well as in conflict with the decision of this Court in *United States* v. *Britton, supra* (107 U.S. 655, 668).[7]

This indictment charges Petitioners with conspiracy to perform acts which are neither individually nor in combination a violation of any law of the United States. The mere legal conclusion that monies were to be wilfully misapplied (which is in itself contrary to the well-pled facts) is not sufficient to state the offense which the indictment purports to charge.

B. This prosecution deprives Petitioners of due process of law because the Petitioners did not have prior notice that the acts charged were criminal acts.

Argument

The Court of Appeals' decision conflicts with applicable principles of this Court concerning the judiciary's policy in cases where the Justice Department seeks to expand the use of criminal statutes beyond a reasonable point, and particularly in complex situations involving no fair notice or warning to Petitioners in advance of the abrupt change in prosecution policy. A decision by this Court becomes even more urgent when it is noted that Circular No. 31, the basis of this prosecution, was never considered by Congress and that the Comptroller of the Currency never held any hearings nor provided the banking industry with any clear guidelines to govern their lending practices.

The Court of Appeals, in off-hand fashion, held merely that because the misapplication statute (18 U.S.C. § 656) was "old" and "long predated the present prosecution, the indictment is not prohibited by the ex post facto clause" [Appendix A, at A-15].

[7] The indictment is also defective because the words "were to cause" are legally inadequate to allege the crime of a misapplication conspiracy. *United States* v. *Britton,* 108 U.S. 193, 2 S.Ct. 526, 27 L.Ed. 701 (1883) (2 S.Ct. at p. 529).

The Court of Appeals' decision sought to distinguish this Court's well-reasoned holdings and rationale of *United States* v. *Laub,* 385 U.S. 475, 87 S.Ct. 574, 17 L.Ed.2d 526 (1967), and *Raley* v. *Ohio,* 360 U.S. 423, 79 S.Ct. 1257, 3 L.Ed.2d 1344 (1959), as well as the Circuit's own recent decision, *United States* v. *Insco,* 496 F.2d 204 (5th Cir. 1974). The Circuit totally ignored this Court's holding in *Bouie* v. *Columbia,* 378 U.S. 347, 84 S.Ct. 1697, 12 L.Ed.2d 894 (1964).

It is clear that these Supreme Court decisions trace the preservation by this Court of a fundamental principle designed to protect the constitutional concept of fair notice or warning. *Raley* (1959), *Bouie* (1964), and *Laub* (1967) reflect a consistent concern by this Court over Government attempts to expand criminal statutes. *Raley* concerned the Government's "active misleading" of the defendant, and stated the principle that "vague and undefined" commands afford no fair warning to citizens of what conduct might expose them to prosecution. [79 S.Ct. 1266]. *Bouie* also applied the basic principle that a criminal statute give fair warning, and again recognized that the fair notice principle applies to retroactive criminal prohibitions emanating from courts as well as legislatures.

Executive Department expansion of a criminal statute was held equally defective three years later in *Laub. Laub's* fact situation is similar to that herein. In *Laub,* the Justice Department contended that although Section 215(b) of the Immigration & Nationality Act of 1952, regulating passport travel, did not ". . . in so many words . . ." prohibit violations of area restrictions, that the text was broad enough to encompass departures for geographically restricted areas [87 S.Ct. at 577-578]. This Court disagreed and, in so holding, stated the governing principle here:

> "Crimes are not to be created by inference. They may not be constructed *nunc pro tunc.*" 87 S.Ct. at 581.

This Court then set out prior decisions setting forth circumstances where a defense of no fair notice had been sustained, such as "authoritative assurances" by the Government; "vague and undefined" commands; "inexplicably contradictory" commands; or "active misleading" by the Government.

The Court of Appeals' decision here held that although certain features of *Raley* and *Laub* were present, such as widespread practices and an absence of prior prosecutions, that because the Government had never approved the making of such loans nor vouched for the propriety of such transactions, Governmental silence did not constitute "affirmative assurance" or "active misleading", and thus *Raley* and *Laub* were not applicable [Appendix A, at A-17].

But the history of Governmental policy of these loans clearly establishes that not only were the policies of various agencies of the Federal Government in a state of flux, but also that these agencies were holding public hearings in Washington *three years before* the indictment and performing acts constituting "active misleading" in this complex area of banking law.

Reference has already been made above to the conflicting opinions concerning the legality of compensating balance lending practices expressed in correspondence from the Comptroller of the Currency and the Department of Justice [at pp. 11-14 herein]. In addition, public testimony and evidence before the Senate Banking Committee in September, 1970 on proposed amendments to the Bank Holding Company Act of 1956 reveal a clear intention on the part of both committee members and Treasury officials to draft such amendments carefully so as not to outlaw traditional and unobjectionable compensating balance loans in circumstances similar to the one involved in the instant case. For example, Samuel R. Pierce, Jr., general counsel, Department of the Treasury, told the Committee that

his agency was generally "...in favor of an anti-tying provision being included in the bill but [did] not believe it should cover traditional banking arrangements such as requiring a loan customer or a correspondent bank to maintain certain balances as compensation for a loan or for services rendered the correspondent bank." 116 Cong. Rec., at 32128 (1970). Similar views were expressed by Senators Bennett and Brooke and by Arthur F. Burns, Chairman, Board of Governors, Federal Reserve System.[8] 116 Cong.Rec. at 32124-32129 (1970).

The Senate report on the bill contains similar assurances. The Senate Committee on Banking and Currency told the regulatory agencies, particularly the Federal Reserve Board, that it (the Senate) "...expects that by such regulation or order the *Board will continue to allow appropriate traditional banking practices.*" 1970 U.S. Code Cong. & Ad. News, 5535. [emphasis added]

Thus, there was "affirmative assurance" or "active misleading" by the Government in 1970 which calls into sharp focus the holdings in *Raley* and *Laub*. The record shows here that, even though the Government was given an opportunity to rebut this evidence, it did not do so.

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[8] Chairman Burns' opinion is particularly enlightening:

> " . . . *'Similarly, the language is not intended to effect bank correspondent relationships, but insures that traditional correspondent relationships cannot be perverted by being tied to or conditioned upon maintenance or establishment of relationships with nonbank subsidiaries of bank holding companies, or with businesses operated within the bank or by the people controlling a bank. Also, the language is not intended to prevent such traditional banking practices which protect extensions of credit by agreement to restrict other borrowing,* but insures that such agreements may not be tied to or conditioned upon an agreement not to do business with competitors of other subsidiaries of the bank holding company, the bank, or of the operators of the bank.'
>
> The Board believes that it is better to include exemptions in the statute than to leave them to administrative discretion, and accordingly we recommend adoption of the amendment." (at 32126) (emphasis added.)

The Court of Appeals also gravely erred by holding that because the indictment charged violations of 18 U.S.C. § 656 occurring *after* Circular No. 31 (October 22, 1970) by virtue of subsequent *renewals* of the loan, that the *Raley* and *Laub* defense could not apply. The Court held that because the Petitioners, at the time of the *renewals* in 1971 would have been put on notice of Circular No. 31, that the Petitioners' "fair notice" defense was not valid.

This holding directly conflicts with a well-established decision of this Court 90 years ago in *Coffin* v. *United States*, 156 U.S. 432, 15 S.Ct. 394, 40 L.Ed. 1109 (1895). *Coffin* held that *renewals* of a loan did not constitute additional crimes in a misapplication indictment. Thus, the Court of Appeals erred in so holding. As a conspiracy indictment, this case *must* stand or fall on whether the alleged agreement to make the loan was an unlawful agreement to make the original alleged misapplication, not on the basis of the renewals. Therefore, *Raley* and *Laub* are still relevant to the defense.

Finally, the Court of Appeals refused to apply its own doctrine as decided in *United States* v. *Insco*, 496 F.2d 204 (5th Cir. 1974), which reversed a finding of guilt where the defendant was "inadequately apprised" of the provisions of law governing his conduct. The Circuit held there that there was no significant evidence that Congress intended the acts to be covered although the acts could be of such a nature to fall within the statute [496 F.2d at 208]; and that three interrelated factors deprived the defendants there of fair notice:

1. Absence of legislative history, even though Congress was presumed to know of the existence of the prohibited material;

2. Presence of a universal practice;

3. Absence of any prosecutions.

The Circuit stated in *Insco* that by the combination of these factors and the absence of judicial decisions, the defendant was "lulled" into the reasonable impression that his conduct did not violate the law because defendant "lacked authoritative guidance" [496 F.2d at 208-209].

Although *all* of these factors were present here to "lull" these Petitioners into relying on Government inaction, the Circuit erroneously held *Insco* did not apply here [Appendix A, at A-17, n. 7].

II. THE COURT OF APPEALS DECIDED AN IMPORTANT QUESTION OF LAW WHICH HAS NOT BEEN, BUT SHOULD BE, SETTLED BY THIS COURT BECAUSE THIS CASE INVOLVES THE NATION'S ENTIRE NATIONAL BANKING INDUSTRY AND IS A CASE OF FIRST IMPRESSION IN THIS COURT. THE INDICTMENT PRESENTS ALLEGATIONS OF FACT NOT HERETOFORE BELIEVED BY THE BANKING INDUSTRY TO CONSTITUTE A CRIME, NOR EXPRESSLY PROHIBITED BY ANY STATUTE OR REGULATION, AND INVOLVING A PRACTICE WHICH THE DEPARTMENT OF JUSTICE CONCEDES TO BE COMMON AND WIDESPREAD. IN ADDITION, THE TRANSACTION FOR WHICH PETITIONERS HAVE BEEN INDICTED AS CONSTITUTING A WILLFUL MISAPPLICATION OF BANK FUNDS WITHIN THE MEANING OF 18 U.S.C. § 656 HAS BEEN TREATED INCONSISTENTLY BY THE COMPTROLLER OF THE CURRENCY AND THE DEPARTMENT OF JUSTICE, CAUSING WIDESPREAD CONFUSION IN THE BANKING INDUSTRY, AND IS OF A TYPE WHICH IS STILL BEING SANCTIONED BY THE FEDERAL RESERVE BOARD.

Argument

This Court should settle the important question of federal law for two principal reasons.

1. *The Court of Appeals' Decision Conflicts With Rulings of the Federal Reserve System.*

The Board of Governors of the Federal Reserve System has considered in three cases the applications of bank

holding companies to acquire the shares of a bank with the proceeds of a loan at a preferential rate on the implied condition that the lender will profit from the transactions by receiving a compensating balance as part of the acquired banks' correspondent accounts. [Decisions attached hereto in Appendix D, at D-1 through D-11]

The minority of the Board of Governors has expressly condemned "compensating balance" loans, yet the majority, including Chairman Burns, continues to approve such loans.[9]

The Board has either repudiated or substantially conflicted with the position of the Justice Department with respect to the construction of Section 656 in a bank holding company context.

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[9] A typical dissent points out the divergence of views within the Federal Reserve System:

> "We would deny this application for the reason that we believe it is not in the public interest to sanction an arrangement whereby owners of 80 per cent of the shares of Bank secured a loan to purchase such shares at a preferential rate (5 per cent) on the implicit condition that the lending bank will profit from the transaction by receiving a compensating balance as part of Bank's correspondent account. Thus, Bank's resources are being used to subsidize the personal interests of shareholders owning 80 per cent of the bank.
>
> In our view, if bank stock loans are to be made, they should be made on the same basis as stock collateral loans in general. We are concerned that such preferential loans could result in conflict of interest or breach of fiduciary duty on the part of the borrowing officer or director if the reduction in the interest rate is conditioned on the maintenance of correspondent balances with the lending bank. Accordingly, in our judgment, the Board should not approve this holding company application and thereby sanction the use of such preferential loans.
>
> A further concern of ours, though one which does not appear to be present in the facts of record involved in this case, is that the making of bank stock loans at less than the prevailing interest rate may be a means whereby a lending bank, without the necessity of securing prior Board approval, acquires indirect control of the borrowing bank's shares which are pledged as collateral.
>
> For the foregoing reasons, we would deny the application." [60 Federal Reserve Bulletin, 729, 730]

2. *Impact Of The Decision On The Banking System.*

The issuance by the Justice Department of Circular No. 31 resulted in unnecessary confusion and apprehension in the American banking industry. The Office of the Comptroller of the Currency emphasized this uncertainty in a letter to Henry E. Peterson, Assistant Attorney General, Criminal Division, on March 21, 1973 [R. 843]. According to the Comptroller:

> "(S)ince dissemination of Mr. Wilson's memo in 1970, there has been *widespread confusion* and concern among bankers as to what combination of facts would give rise to a violation. . . . The fact is that none of the attempts at clarification in this grey area have been successful and as of today bankers still are not sure of the circumstances under which they safely can maintain on their books simultaneously a deposit from a correspondent bank and a loan to a principal of that bank even though *such a combination is a common and natural occurrence* in many completely legitimate and routine situations." (emphasis added.)[10]

Furthermore, if the decision of the Fifth Circuit is allowed to stand, confusion similar to that resulting from the issuance of Circular No. 31 will occur in the banking industry. The Fifth Circuit decision lends only more confusion to members of the banking profession sorely in need of proper guidance and who now must determine daily when an "interbank deposit" shifts in character from a normal "correspondent account" to a prohibited "compensating balance"; when the interest rate on a loan to a bank official changes from a rate permitted under our concepts of private contract to a prohibited "preferential" rate; and when

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[10] While total figures for all banks across the nation are not available, the record indicates that 110 prospective cases involving transactions similar to the one for which Petitioners are being prosecuted herein exist in the records of the United States Attorney for the Southern District of Texas [R. 781], and if the Fifth Circuit decision correctly states the law, there are at least 110 other members of the banking community who will be exposed to the uncertainty of criminal prosecution under the broadened interpretation of 18 U.S.C. § 656.

a loan to a bank officer at a rate which is not "preferential" but requires a "compensating balance" from the officer's bank violates 18 U.S.C. § 656.

Since all banks must maintain a large portion of their total assets in the form of cash due from other banks, and since loans to officers of correspondent banks are "common and natural occurrences" in the industry, as substantial a change in the law as is contemplated by the Fifth Circuit opinion should be reviewed by this Court.

III. THE COURT OF APPEALS, IN ITS DECISION, HAS SO FAR DEPARTED FROM THE ACCEPTED AND USUAL COURSE OF JUDICIAL PROCEEDINGS AS TO CALL FOR THIS COURT'S POWER OF SUPERVISION. THE COURT OF APPEALS HELD THAT AT A RULE 12 HEARING ON MOTION TO DISMISS THE DEFENSES OF LACK OF FAIR NOTICE TO THE PETITIONERS AND OF VIOLATION OF PETITIONERS' CONSTITUTIONAL RIGHT OF DUE PROCESS WERE NOT CAPABLE OF DETERMINATION BASED ON UNDISPUTED EVIDENCE WITHOUT TRIAL OF THE GENERAL ISSUE.

Argument

The holding conflicts with *United States* v. *Laub,* 385 U.S. 475, 87 S.Ct. 574, 17 L.Ed.2d 526 (1967).

Such a holding emasculates the purpose of Fed. R. Crim. P. 12, and denies a defendant the right to present evidence of defenses capable of determination at a pre-trial hearing and impairs the District Court's ability to make findings on undisputed evidence.

The Court of Appeals' holding disrupts orderly criminal pre-trial hearing procedure on two vital points, i.e., what defenses are capable of determination without a trial, and what evidence is admissible to support the trial court's findings.

This Court has held that under Fed. R. Crim. P. 12, it was appropriate for Petitioners to raise defenses relating to due process of law at a pre-trial hearing. *United States* v. *Laub,* 385 U.S. 475, 87 S.Ct. 574, 17 L.Ed.2d 526 (1967). The record in *Laub* reveals the indictment was dismissed without a trial and Petitioners' defenses were established by evidence of Government press releases, Government public notices, and records of Congressional hearings.

The Court of Appeals here held Petitioners' evidence not only did not prove circumstances of a *Laub* fair notice defense, but also was inadmissible at a Rule 12 hearing because it went to the general issue of intent. The Court of Appeals did not specify what evidence supported such a holding. Under *Laub,* Petitioners were entitled to present evidence of government conduct to prove their defense of no fair notice at the hearing on the Motion to Dismiss. The fact that such evidence may later be admissible at trial to show lack of specific intent is immaterial.

Furthermore, as this Court held in *United States* v. *Covington,* 395 U.S. 57, 89 S.Ct. 1559, 23 L.Ed.2d 94 (1969), under similar circumstances, the evidence so presented was capable of determination without a trial and the Government should have, *at that time,* attempted to rebut the evidence. (89 S.Ct. at 1561).

The subject of what issues are capable of determination under Rule 12 has been in urgent need of resolution by this Court, and, on occasion, has been the cause of apparent disagreement in this Court, particularly in appeals by the Government in dismissed cases. *United States* v. *Sisson,* 399 U.S. 267, 90 S.Ct. 2117, 26 L.Ed.2d 608 (1970).[11] The Advisory Committee has not defined the subject with much clarity.

The problem becomes acute when viewed in the context of this case where classic defenses of fair notice were raised

[11] The Court of Appeals apparently misread this Court's holding in *United States* v. *Pennsylvania Industrial Chemical Corporation,* 411 U.S. 655, 93 S.Ct. 1804, 36 L.Ed.2d 567, (1973), and construed the holding to mean that Petitioners' *only* opportunity to prove a fair notice defense was at trial.

and when persuasive, undisputed evidence was produced fully supporting the trial court's order of dismissal. The Government never rebutted the evidence, yet Petitioners have been ordered to stand trial because the Court of Appeals failed to properly decide the *Laub* issue.

CONCLUSION

For the reasons stated herein, Petitioners pray that this Petition for Certiorari to the United States Court of Appeals for the Fifth Circuit be granted.

Respectfully submitted,

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APPENDIX A

Opinion and Judgment of the Court of Appeals

United States Court of Appeals

FIFTH CIRCUIT

No. 74-2983

UNITED STATES OF AMERICA

PLAINTIFF-APPELLANT,

v.

ROBERT A. MANN AND BANK OF THE SOUTHWEST, NATIONAL ASSOCIATION,

DEFENDANTS-APPELLEES

Aug 7, 1975

Appeal from the United States District Court for the Southern District of Texas.

Before GIBSON,* THORNBERRY and AINSWORTH, Circuit Judges.

AINSWORTH, Circuit Judge:

This important criminal case involves the validity of an indictment charging misapplication of bank funds in connection with a multimillion dollar loan to a bank official at a preferential rate of interest, conditioned on his bank depositing an equal amount in a non-interest bearing account in the lending bank. The district judge dismissed the indictment for numerous reasons which he assigned. We disagree with those reasons and reverse.

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*Of the Eighth Circuit, sitting by designation.

I. The Facts

Robert A. Mann, who is Chairman of the Board of Directors and Chief Executive Officer of the First National Bank of Waco, Texas, and Bank of the Southwest, National Association of Houston, Texas, were jointly charged in a one-count indictment with a violation of 18 U.S.C. § 371 by conspiring during the period from December 1969 until February 1972 to knowingly and willfully misapply the monies and funds of the First National Bank of Waco, with intent to injure and defraud said bank by causing the funds to be converted to the use, benefit and advantage of the defendant, Mann, in violation of 18 U.S.C. § 656. Section 656 provides in pertinent part:

> Whoever, being an officer, director, agent or employee of, or connected in any capacity with any Federal Reserve bank, member bank, national bank or insured bank, . . . embezzles, abstracts, purloins or willfully misapplies any of the moneys, funds or credits of such bank or any moneys, funds, assets or securities intrusted to the custody or care of such bank, or to the custody or care of any such agent, officer, director, employee or receiver, shall be fined not more than $5,000 or imprisoned not more than five years, or both; but if the amount embezzled, abstracted, purloined or misapplied does not exceed $100, he shall be fined not more than $1,000 or imprisoned not more than one year, or both.
>
> • • •

In substance, the indictment charged that defendant Mann was to acquire controlling interest in the First National Bank of Waco for the purchase price of approximately $6,900,000, to be financed by a loan in this amount from defendant Bank of the Southwest. The Republic National Bank of Dallas was to participate in the loan to the extent of $2,900,000, leaving $4,000,000 as the amount of the loan to Mann from Bank of the Southwest. The loan was to be at the rate of interest of 3 per cent per annum, notwithstanding the fact that the prime rate of interest

charged by Bank of the Southwest at the time was 8½% per cent. To compensate Bank of the Southwest for extending the loan to Mann at the preferential rate of interest of 3 per cent, Bank of the Southwest was to require Mann to place on deposit with Bank of the Southwest funds of the First National Bank of Waco in an amount commensurate with the principal amount of the loan, i.e., $4,000,000, in a non-interest bearing account until the principal was reduced or paid in full. Thus, according to the indictment, the monies and funds of the First National Bank of Waco were "converted to the use, benefit and advantage of the defendant, Robert A. Mann," and the preferential 3 per cent loan saved Mann approximately $350,000 per year in interest charges.

The indictment further alleged that defendants agreed that if the $4,000,000 principal was reduced but not paid in full, the amount of the non-interest bearing account to be kept by Mann in the Bank of the Southwest would be reduced by an amount commensurate with the reduction in principal. Accordingly, when Mann reduced the principal amount of the loan from $4,000,000 to $3,000,000, the compensating balance of $4,000,000 was also reduced to $3,000,000, and the rate of interest was increased from 3 per cent to 4 per cent, though Bank of Southwest's prime rate at that time was 6 per cent, thus saving Mann $110,000 per year in interest charges.

Finally, the indictment charged that to effect the object of the conspiracy, and in furtherance thereof, certain described overt acts were committed. Since the validity and sufficiency of the indictment are at issue, the full text of the indictment is reproduced in the margin.[1]

---

[1] The Grand Jury charged:

> Beginning on, or about, December 9, 1969, and continuing to on, or about, February 28, 1972, within the Houston Division of the Southern District of Texas, defendants, Robert A. Mann, Chairman of the Board of Directors and Chief Executive Officer of First National Bank of Waco, Waco, Texas, and Bank of the Southwest, National Association, Houston, Texas, and un-

indicted co-conspirator, Weyman W. Horadam, Senior Vice-President of Bank of the Southwest, National Association, Houston, Texas, and diverse other persons whose names are to the Grand Jury unknown, combined, conspired, agreed and confederated to commit an offense against the laws of the United States, to-wit: to knowingly and willfully misapply monies and funds of the First National Bank of Waco, a national bank and a member bank, with intent to injure and defraud said bank by causing said monies and funds to be converted to the use, benefit and advantage of the defendant, Robert A. Mann, in violation of Title 18, United States Code, Section 656.

The object of the conspiracy was to be accomplished as follows:

The defendant, Robert A. Mann, was to acquire controlling interest in the stock of First National Bank of Waco for the purchase price of approximately $6,900,000.00.

To finance the purchase of the aforesaid stock, the defendant, Robert A. Mann, was to borrow $6,900,000.00 from the defendant, Bank of the Southwest.

Unindicted co-conspirator Weyman W. Horadam was to act as an officer and agent of defendant, Bank of the Southwest, and was to arrange for the defendant, Bank of the Southwest, to lend $6,900,000.00 to the defendant, Robert A. Mann.

The defendant, Bank of the Southwest, was to extend credit and fund the aforesaid $6,900,000.00 loan to the defendant, Robert A. Mann, at the rate of interest of three per cent (3%) per annum notwithstanding the fact that the prime rate of interest per annum charged by the defendant Bank of the Southwest, at such time was eight and one-half per cent (8½%).

The defendant, Bank of the Southwest, was to sell a participation of $2,900,000.00 of the loan to the defendant, Robert A. Mann, to Republic National Bank, Dallas, Texas, thereby rendering defendant, Bank of the Southwest's, extension of credit and funding of the aforesaid loan to the defendant, Robert A. Mann, $4,000,000.00.

To compensate the defendant, Bank of the Southwest, for extending and funding the aforesaid $4,000,000.00 loan to the defendant, Robert A. Mann, at the preferential rate of interest of three per cent (3%) per annum, the defendant, Bank of the Southwest, was to require the defendant, Robert A. Mann, to place on deposit with defendant, Bank of the Southwest, an amount of money commensurate with the principal amount of the loan, to-wit: $4,000,000.00, which money was to be placed in a non-interest bearing account until such time as the said $4,000,000.00 principal was reduced or was paid in full.

The defendant, Robert A. Mann, was to cause $4,000,000.00 of monies and funds of the First National Bank of Waco to be

placed on deposit in the aforesaid non-interest bearing account at the defendant, Bank of the Southwest, whereby the use, benefit and advantage of said monies and funds was converted from the First National Bank of Waco to the use, benefit and advantage of the defendant, Robert A. Mann.

By reason of the aforesaid $4,000,000.00 to be placed on deposit in a non-interest bearing account at the defendant, Bank of the Southwest, the defendant, Robert A. Mann, was to receive the preferential rate of interest on the aforesaid loan of three per cent (3%) per annum, thereby saving the defendant, Robert A. Mann, approximately $350,000.00 per year in interest charges.

The defendants, Robert A. Mann and Bank of the Southwest, were to agree that if the $4,000,000.00 principal was reduced, but not paid in full, by the defendant, Robert A. Mann, then in such event, the amount of money required to be kept by the defendant, Robert A. Mann, in the non-interest bearing account at the defendant, Bank of the Southwest, would be reduced by an amount commensurate with said reduction in the principal.

The defendant, Robert A. Mann, was to cause the principal amount of the aforesaid loan to be reduced from $4,000,000.00 to $3,000,000.00, at which time the defendant, Bank of the Southwest, was to cause the rate of interest charged per annum on said loan to be increased from three per cent (3%) to four per cent (4%), notwithstanding the fact that the prime rate of interest charged by the defendant, Bank of the Southwest, at such time was six per cent (6%) per annum.

The defendant, Bank of the Southwest, was to further permit the defendant, Robert A. Mann, to reduce the amount of money required to be kept on deposit in the aforesaid non-interest bearing account at the defendant, Bank of the Southwest, from $4,000,000.00 to $3,000,000.00.

The defendant, Robert A. Mann, was to cause $1,000,000.00 of the $4,000,000.00 of monies and funds of the First National Bank of Waco, Texas, then and there on deposit with the defendant, Bank of the Southwest, to be withdrawn therefrom and was to cause the remaining $3,000,000.00 of monies and funds of the First National Bank of Waco, Waco, Texas, to continue to remain on deposit in the aforesaid non-interest bearing account at the defendant, Bank of the Southwest, whereby the use, benefit and advantage of said monies and funds were converted from the First National Bank of Waco, Waco, Texas to the use, benefit and advantage of the defendant, Robert A. Mann.

By reason of the aforesaid $3,000,000.00 continuing to remain on deposit in a non-interest bearing account at the defendant, Bank of the Southwest, the defendant, Robert A. Mann, was to receive the preferential rate of interest on the aforesaid loan of four per cent (4%) per annum, thereby saving the defend-

Both defendants filed motions to dismiss the indictment under Rule 12 of the Federal Rules of Criminal Procedure, and a hearing was held on the motions as provided by Rule 12(b)(4) of said rules. Numerous grounds for dismissal were asserted in these motions, especially that the allegations contained in the indictment did not state an offense in violation of any law of the United States, and further that the indictment should be dismissed because prosecution thereunder was in violation of several

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ant, Robert A. Mann, approximately $110,000.00 per year in interest charges.

During the existence of the aforesaid loan, the defendant, Bank of the Southwest, was to receive a constant return on the loan made to the defendant, Robert A. Mann, at the rate of approximately seven and one-quarter per cent (7¼%) per annum notwithstanding the increase in the rate of interest charged from three per cent (3%) per annum to four per cent (4%) per annum and notwithstanding the decrease in the amount of money required of the defendant, Robert A. Mann, to be kept on deposit at the defendant, Bank of the Southwest, from $4,000,000.00 to $3,000,000.00.

To effect the object of the conspiracy and in furtherance thereof, the defendants, Robert A. Mann and Bank of the Southwest, and unindicted co-conspirator Weyman W. Horadam committed diverse overt acts, among which are the following:

1. On, or about, December 12, 1969, defendant, Robert A. Mann and unindicted co-conspirator Weyman W. Horadam had a meeting in Houston, Texas.

2. On, or about, December 12, 1969, defendant, Bank of the Southwest made a loan to defendant, Robert A. Mann.

3. On, or about, June 11, 1970, defendant, Bank of the Southwest renewed the aforesaid loan to defendant, Robert A. Mann.

4. On, or about, January 15, 1971, defendant, Bank of the Southwest, renewed the aforesaid loan to defendant, Robert A. Mann.

5. On, or about, July 28, 1971, defendant Bank of the Southwest renewed the aforesaid loan to defendant, Robert A. Mann.

6. On, or about, August 26, 1971, defendant Bank of the Southwest, renewed the aforesaid loan to defendant, Robert A. Mann.

(Violation: Title 18, United States Code, Section 371)

provisions of the Constitution, especially the ex post facto clause of Section 9 of Article 1 and the due process clause of the Fifth Amendment. Defendants contended, among other things, that the indictment failed to allege an offense because the bank loan was lawful at the time it was made, that the allegations in the indictment were vague and indefinite, that defendants had been denied due process of law because the prosecution resulted in an ex post facto application of criminal statutes, and that the Government was attempting to regulate private business transactions by criminal prosecution.

At the hearing the district court allowed the defendants to introduce into evidence, over strenuous opposition of the Government, a large volume of documentary evidence, much of which came from the files of the Government. The Government's objection was that defendants were attempting to try the general issues of fact at the summary hearing on the motions to dismiss. The district judge agreed, however, with the contentions of defendants and dismissed the indictment for written reasons which as assigned as follows:

> Based upon the evidence that is not in dispute, and those facts which have been stipulated, and the matters of which the Court can take judicial notice, the Court is of the opinion that the indictment must be dismissed for the following reasons and none other.
>
> Firstly, the Defendants have been denied due process of law.
>
> The Defendants have been denied equal protection of the law.
>
> The indictment fails to state an offense on its face.
>
> The indictment is too vague and indefinite to sustain a prosecution.
>
> 18 U.S.C. Sec. 656, as applied in this case, is also too vague and indefinite to sustain a criminal prosecution.

This prosecution is precluded because it violates the ex post facto clause of Section Nine of Article One of the United States Constitution.

The indictment should be dismissed because it is an unlawful retroactive application of governmental policy as it affects this criminal prosecution.

Lastly, the indictment must be dismissed because it is against the public policy of the United States to regulate private business by criminal prosecution as was done in this case. The Court is relying upon the *United States of America* vs. *Jack P. Ensco* [sic], No. 73-3990, Fifth Circuit, June 21, 1974.

The Court accepts the Defendants' theory of the law as it applies to the above reasons for dismissing the indictment.

For these reasons and for no others, except those stated above, the Court dismisses the indictment.

This is a FINAL JUDGMENT.

The Government has appealed the dismissal of the indictment under the Criminal Appeals Act, 18 U.S.C. § 3731. At the outset, defendants contend that the appeal is barred by the double jeopardy clause of the Fifth Amendment. They maintain that though the district judge dismissed the indictment, what he actually did in fact was to acquit the defendants upon findings of facts outside the indictment which constituted a defense on the merits. Accordingly, we must initially dispose of that issue prior to any inquiry into the question whether the indictment sufficiently sets forth a violation of a federal criminal statute, or whether defendants have been indicted and prosecuted for unconstitutional reasons requiring dismissal of an otherwise valid indictment.

II. Double Jeopardy

In arguing that the double jeopardy clause prohibits the Government's appeal in this case, defendants rely on *United States* v. *Lewis,* 5 Cir., 1974, 492 F.2d 126. In *Lewis,* the trial court dismissed an indictment after an evidentiary hearing but prior to trial. This Court dismissed the Government's appeal from the district court's ruling and held that "double jeopardy precludes retrial when the district court has ruled in favor of the defendant on facts going to the merits of the case if these facts were adduced at an evidentiary hearing." 492 F.2d at 127. However, the Supreme Court vacated the decision in Lewis, — U.S. —, 95 S.Ct. 1671, 44 L.Ed.2d 97 (1975), and remanded the case for consideration in light of the Court's decision in *Serfass* v. *United States,* 420 U.S. —, 95 S.Ct. 1055, 43 L.Ed.2d 265 (1975). Therefore, the principles enunciated in *Serfass* are controlling on this issue.

The Supreme Court in *Serfass* reiterated the principle that jeopardy does not attach until the defendant is " 'put to trial before the trier of facts, whether the trier be a jury or a judge.' " 420 U.S. at —, 95 S.Ct. at 1062, quoting *United States* v. *Jorn,* 400 U.S. 470, 479, 91 S.Ct. 547, 554, 27 L.Ed.2d 543 (1971). In *Serfass,* the district court dismissed the indictment after a pretrial evidentiary hearing. But the defendant had not waived his right to a jury trial, and jeopardy therefore had not attached as a result of an evidentiary hearing before the district court. The Supreme Court noted that "[i]n such circumstances, the District Court was without power to make any determination regarding [the defendant's] guilt or innocence." 420 U.S. at —, 95 S.Ct. at 1063. "Without risk of determination of guilt, jeopardy does not attach, and neither an appeal nor further prosecution constitutes double jeopardy." 420 U.S. at —, 95 S.Ct. at 1064. Thus, under *Serfass,* a pretrial order dismissing an indictment is appealable even when the dismissal is based on facts and evidence outside the indictment. A defendant is not placed in jeopardy merely by a

pretrial hearing in the district court, where trial by jury has not been waived, because the trial court is without authority to make any determination regarding guilt or innocence. The decisive inquiry is whether jeopardy had attached at the time an evidentiary hearing was held, and not simply whether such a hearing has taken place.

The evidence received here, over Government objection, was at a hearing under Rule 12(b)(4) on motions to dismiss the indictment, not on the general issue. Defendants not having waived their rights to a trial by jury with the consent of the Government, *see* Fed.R.Crim.P. 23(a), jeopardy has not yet attached in this case and the Government therefore may properly appeal the order dismissing the indictment.

III. Sufficiency of the Indictment

An indictment is sufficient if it, first, contains the elements of the offense charged and fairly informs the defendants of the charge against which they must defend, and second, enables the defendants adequately to plead an acquittal or conviction in bar of future prosecutions for the same offense. *Russell* v. *United States,* 369 U.S. 749, 763-764, 82 S.Ct. 1038, 1047, 8 L.Ed.2d 240 (1962) and cases cited; *United States* v. *Sanchez,* 5 Cir., 1975, 508 F.2d 388, 395. Whether the indictment sufficiently alleges a crime is an issue of law, not of fact. *United States* v. *Miller,* 5 Cir., 1974, 491 F.2d 638, 647, *cert. denied,* 419 U.S. 970, 95 S.Ct. 236, 42 L.Ed.2d 186; *see* Fed.R.Crim.P. 12(b)(1). On review of an order dismissing an indictment, the indictment is to be tested not by the truth of its allegations but "by its sufficiency to charge an offense," *United States* v. *Sampson,* 371 U.S. 75, 78-79, 83 S.Ct. 173, 175, 9 L.Ed.2d 136 (1962), since the allegations contained in the indictment must be taken as true. *United States* v. *National Dairy Products Corp.,* 372 U.S. 29, 33 n. 2, 83 S.Ct. 594, 598 n. 2, 9 L.Ed.2d 561 (1963); *Boyce Motor Lines* v. *United States,* 342 U.S. 337, 343 n. 16, 72 S.Ct. 329, 332 n. 16, 96 L.Ed. 367 (1952).

A defendant may not properly challenge an indictment, sufficient on its face, on the ground that the allegations are not supported by adequate evidence, for an indictment returned by a legally constituted and unbiased grand jury, if valid on its face, is enough to call for trial of the charge on the merits. *Costello* v. *United States,* 350 U.S. 359, 363, 76 S.Ct. 406, 409, 100 L.Ed. 397 (1956).

Defendants continue to maintain here, as they did in the district court, that the indictment is insufficient to allege an offense against the United States. But they erroneously predicate this contention on evidence outside of the indictment which they introduced at the hearing on the motions to dismiss. As we have pointed out above, such evidence is irrelevant to a determination of whether the indictment itself is legally sufficient.

Since the evidence in question has no bearing on the facial validity of the indictment, the district court erred in considering it when deciding whether the indictment alleged a criminal offense. Defendants contend that the evidence conclusively demonstrates that the loan transaction was not entered into "willfully," because it shows that defendants could not have had knowledge that the transaction was prohibited by law at the time it was first made.[2] *Cf.* 1 Devitt & Blackmar, Federal Jury Practice and Instructions §

[2]The Government, both before the district court and here on appeal, strongly objected to the district court's consideration of evidentiary matters contradicting the allegations of the indictment. We believe the objection was well taken. Defendants place themselves in a dilemma responding to this contention. For example, defendant Mann argues on one hand that this appeal should be dismissed on double jeopardy grounds "because the decision of the trial court rests upon evidentiary facts outside the indictment, which facts would constitute a defense on the merits at trial." Brief at p. 5. Subsequently, however, in responding to the Government's attack on the propriety of the extensive evidentiary hearing, it is asserted that "[e]vidence was not offered by Appellees at the Rule 12 hearing for the purpose of disproving the well plead allegations of the indictment." Brief at p. 41. Defendant Mann's first version of the hearing is more accurate.

16.13; 33 F.R.D. 523, 553 (1964). But the Supreme Court has specifically held, in reversing a district court's dismissal of an indictment, that willfullness is an "evidentiary question" that should not be determined in a Rule 12(b) proceeding. *United States* v. *Knox,* 396 U.S. 77, 83 n. 7, 90 S.Ct. 363, 367 n. 7, 24 L.Ed.2d 275 (1969); *see Universal Milk Bottle Service, Inc.* v. *United States,* 6 Cir., 1961, 188 F.2d 959, 962. As the Eighth Circuit has stated, "There is no authority under Rule 12 . . . to dismiss on the basis of a sufficiency-of-the-evidence defense which raises factual questions embraced in the general issue." *United States* v. *Brown,* 8 Cir., 1973, 481 F.2d 1035, 1041 and cases cited.

The essential elements of a substantive violation of 18 U.S.C. § 656 are (1) that the accused was an officer, director, etc. of a bank, (2) that the bank was connected in some capacity with a national or federally insured bank, (3) that the accused willfully misapplied the money, funds, etc. of said bank, and (4) that the accused acted with intent to injure and defraud said bank. *Garrett* v. *United States,* 5 Cir., 1968, 396 F.2d 489, 491, *cert. denied,* 393 U.S. 952, 89 S.Ct. 374, 21 L.Ed.2d 364; *United States* v. *Fortunato,* 2 Cir., 1968, 402 F.2d 79, 82, *cert. denied,* 394 U.S. 933, 89 S.Ct. 1205, 22 L.Ed.2d 463; *United States* v. *Kernodle,* M.D.N.Car., 1973, 367 F.Supp. 844, 850; *United States* v. *Vannatta,* D.Haw., 1960, 189 F.Supp. 939, 941.[3] *See also United States* v. *Bearden,* 5 Cir., 1970, 423 F.2d 805, 810-811, *cert. denied,* 400 U.S. 836, 91 S.Ct. 73, 27 L.Ed.2d 68 (indictment under section 656 sufficient if set out in language of the statute). Since the indictment alleged a conspiracy to commit all the substantive elements constituting a misapplication of bank funds under 18 U.S.C. § 656, it sufficiently alleged a violation of federal criminal statutes.

[3] "Intent to injure or defraud" is an essential element of a Section 656 violation and must be proved. Some cases have suggested, however, that this need not specifically be alleged because the allegation of willful misapplication sufficiently imports an intent to injure or defraud. See Ramirez v. United States, 9 Cir., 1963, 318 F.2d 155, 157-158; Reviser's Note to 18 U.S.C. § 656. Since the indictment in this case specifically alleges that the defendants acted with intent to injure or defraud, we need not decide whether failing to so allege constitutes a fatal defect in an indictment.

Other contentions by defendants that the indictment is insufficient are without merit. It is not necessary for the Government to allege that the misapplication was without the knowledge and consent of the First National Bank of Waco or its board of directors, since such consent is a matter of defense. *United States* v. *Klock,* 2 Cir., 1954, 210 F.2d 217, 220 (Frank, J.); *Mulloney* v. *United States,* 1 Cir., 1935, 79 F.2d 566, 581, *cert denied,* 296 U.S. 658, 56 S.Ct. 383, 80 L.Ed. 468. It is not necessary for the Government to allege or prove that the bank actually suffered any loss as a result of defendants' actions. *United States* v. *Rickert,* 5 Cir., 1972, 459 F.2d 352, 354; *United States* v. *Acree,* 10 Cir., 1972, 466 F.2d 1114, 1118, *cert denied,* 410 U.S. 913, 93 S.Ct. 962, 35 L.Ed.2d 278 (1973); *United States* v. *Fortunato,* 2 Cir., 1968, 402 F.2d 79, 81, *cert denied,* 394 U.S. 933, 89 S.Ct. 1205, 22 L.Ed.2d 463. Nor is it necessary for the Government to allege in the indictment that the bank's funds were converted to the use of the defendants or others, for it is not necessary to set forth the means by which the offense was committed. *United States* v. *Fortunato, supra,* 402 F.2d at 82; *United States* v. *Moraites,* 3 Cir., 1972, 456 F.2d 435, 440-441, *cert. denied,* 409 U.S. 891, 93 S.Ct. 109, 34 L.Ed.2d 148. Though it was not necessary to allege conversion, the indictment does allege that the monies and funds of the First National Bank of Waco were "converted to the use, benefit and advantage of the defendant, Robert A. Mann," and thoroughly details how the conversion was accomplished. Conversion is sufficiently alleged in this indictment, though it was not necessary that the indictment do so. Since the term "misapplied" has acquired its own technical meaning, alleging misapplication is sufficient to charge an individual with a crime, *see United States* v. *Wilson,* 5 Cir., 1974, 500 F.2d 715, 720; *United States* v. *Moraites, supra,* 456 F.2d at 440-441 & n. 9; *United*

States v. *Meyer*, 5 Cir., 1959, 266 F.2d 747, 754, *cert. denied*, 361 U.S. 875, 80 S.Ct. 138, 4 L.Ed.2d 113, and an indictment alleging the misapplication of funds is not unconstitutionally vague. *See, e. g., United States* v. *Wilson, supra*, 500 F.2d at 720; *United States* v. *Cooper*, 10 Cir., 1972, 464 F.2d 648, 651, *cert. denied*, 409 U.S. 1107, 93 S.Ct. 902, 34 L.Ed.2d 688 (1973); *United States* v. *Fortunato, supra*, 402 F.2d at 82.

We are in agreement, therefore, with the recent decision of the Tenth Circuit which held that an indictment alleging the use of an interbank deposit as a compensating balance for a loan at a preferential rate to an official of the depositing bank alleges an offense in violation of 18 U.S.C. § 656. *United States* v. *Brookshire*, 10 Cir., 1975, 514 F.2d 786 [1975].[4] Since the indictment in the present case alleged a conspiracy to misapply bank funds in order to receive a preferential interest rate, the indictment sufficiently alleges an offense.

IV. Dismissal of the Indictment on Constitutional Grounds

Defendants raise numerous challenges to the application of the criminal statute to them under the facts of the case. The first contention that prosecution is barred by the ex post facto clause of the Constitution is without merit. It is settled that the ex post facto clause is applicable to a law which "makes an action done before the passing of the law, and which was innocent when done, criminal; and punishes such action" or one which "aggravates a crime, or makes it greater than it was, when committed." *Calder* v. *Bull*, 3

[4] Defendants seeks to distinguish the *Brookshire* case chiefly on the basis that the compensating balance agreement in question in that case was entered into after the issuance of Circular 31 (*see infra*). But, as we have stated, the presence or absence of Circular 31 in this case is irrelevant to the issue whether the indictment alleges an offense. Moreover, even assuming that Circular 31 and its date of issuance, October 22, 1970, is significant, the Government alleges (and it must be accepted as true) that the loan in question was renewed on several occasions after the issuance of Circular 31.

Dall. (3 U.S.) 386, 390, 1 L.Ed. 648 (1798). The misapplication statute is an old statutory prohibition, enacted in its present form in 1948, *see* 62 Stat. 729, but having antecedents going back into the 19th Century. *See* Rev. Stat. 5209, p. 1007 (1873-74); *United States* v. *Britton*, 107 U.S. 655, 2 S.Ct. 512, 27 L.Ed. 520 (1883). Inasmuch as the statute and its penalty long predated the present prosecution, the indictment is not prohibited by the ex post facto clause.

Defendants also argue, however, that this prosecution is prohibited because it constitutes an ex post facto application of criminal sanctions and is an unlawful retroactive application of government policy. They contend that there had been no prosecutions of the present nature or specific warning that the conduct under scrutiny in this case was deemed to be criminal prior to the issuance of Banking Circular No. 31 in 1970, by the Comptroller of the Currency, and that the loan agreement in question was consummated prior to the issuance of Circular 31. Circular 31 was sent to the presidents of all national banks on October 22, 1970, at the request of the Justice Department, some ten months after the consummation of the Mann-Bank of the Southwest loan on December 12, 1969. It advised the bank presidents that although there were no cases "at the present time" construing the use of compensating balances to obtain a preferential rate of interest to be a misapplication of funds under the criminal statutes, some such situations might warrant prosecution action. Additionally, defendants point to a March 21, 1973, letter from Comptroller of the Currency Camp to Assistant Attorney General Petersen in which the Comptroller stated, "It does not appear either possible or fair to charge Mr. Mann or the Bank of the Southwest or the First National Bank of Waco with a willful violation." Moreover, Camp stated, "[I]t appears to me that all parties endeavored to comply in good faith with all governmental requests made upon them and with the law and that it would not be equitable to ask for an indict-

ment based on these facts." Defendants further note that regular bank examinations subsequent to the issuance of Circular 31 gave no indication that the loan in question was considered to be in violation of law. They also point to the fact that when the Deputy Comptroller of the Currency questioned the propriety of the compensating balance and suggested a reduction in the amount of the account, prompt action was taken to reduce the balance on deposit to an appropriate level.[5] Additionally, defendants refer to a letter from John C. Keeney, Chief of the Fraud Section of the Department of Justice, to United States Attorney Anthony Farris dated May 4, 1971, in which Keeney stated in part, "Only in an exceptionaly aggravated situation occurring before the cut-off date involving substantial loss and where the defense of common practice might be overcome, should prosecution under any theory be considered."[6]

[5]The letter to the First National Bank of Waco by Deputy Comptroller of the Currency Gwin is viewed in a different light by the Government. The letter was dated January 25, 1972, one year and three months after the issuance of Circular 31. Gwin's letter states that the Waco Bank's compensating balance with Bank of the Southwest "appears to greatly exceed your bank's legitimate needs." The letter notes that the compensating balance increased some 1,600%, from about $250,000 to $4,000,000, and states that this "marked increase . . . coincided with the Bank of the Southwest's grant of a $6,900,000 3% interest rate loan to Robert A. Mann, Chairman of your board." The Government contends this letter indicates not only that the compensating balance was not justified by legitimate business reasons, but also that the arrangement continued for some time after the issuance of Circular 31.

[6]Keeney's letter also states:

> Although we are satisfied that, in some instances, this practice clearly evinces a misuse of the funds and credits of a bank, it is believed that the prevalence of the practice and the failure of the regulatory agencies to curtail the activity, will make it difficult to predicate a prosecution on conduct occurring before the above dates [the dates on which the Justice Department's views were disseminated to federally supervised and insured banks.].

The letter further states that the fraud Section of the Department of Justice should be consulted before considering any prosecution. The Fraud Section ultimately approved the present prosecution.

In *Raley* v. *Ohio,* 360 U.S. 423, 79, S.Ct. 1257, 3 L.Ed.2d 1344 (1959), the Court held that a citizen could not be convicted "for exercising a privilege which the State clearly had told him was available to him" or if the government conduct constitutes "active misleading" of a person in order to prosecute him. *Id.* at 438, 79 S.Ct. at 1266. The Court reiterated the policy of proscribing certain types of prosecutions in *United States* v. *Laub,* 385 U.S. 475, 87 S.Ct. 574, 17 L.Ed.2d 526 (1967), where, in affirming the dismissal of an indictment, the Court said, "Ordinarily, citizens may not be punished for actions undertaken in good faith reliance upon authoritative assurance that punishment will not attach." *Id.* at 487, 87 S.Ct. at 581. The present case, however, differs from the situation in *Raley* and *Laub.* Only an allegedly widespread practice of entering into preferential loans of the kind involved here, together with an absence of prior prosecutions, can be said to require dismissal of the indictment under the *Raley-Laub* rationale. But the Government has never approved the making of loans under the circumstances here, nor has it previously vouched for the propriety of such transactions. However, governmental silence is not "affirmative assurance that punishment will not attach" and a mere absence of prior prosecutions does not constitute "active misleading," and the decisions in *Raley* and *Laub* are thus not applicable to the circumstances in this case. As the Tenth Circuit said of the compensating balance practice in *United States* v. *Brookshire, supra,* "If, as defendant[s] say, this practice is the usual way in which bankers do business, those who engage in it must suffer the penalty which the law constitutionally provides." 514 F.2d at 790.[7]

[7]Defendants and the district court relied heavily on United States v. Insco, 5 Cir., 1974, 496 F.2d 204, in support of the contention that the prosecution in this case was an unlawful retroactive application of government policy. In *Insco,* this Court reversed the conviction of an unsuccessful candidate for federal office for failing to place an attribution clause on bumper stickers distributed by him, in violation of 18 U.S.C. § 612. Three factors led the Court to this decision: (1) silence in the legislative

Defendants next contend that the indictment should be dismissed because they were unfairly singled out for prosecution. They assert that the compensating balance practice is widespread, and that prosecuting the defendants herein but not others who have engaged in similar activities constitutes selective prosecution which deprives defendants of equal protection of the law. It is the prerogative of the executive to initiate criminal proceedings, *see United States* v. *Cox,* 5 Cir., 1965, 342 F.2d 167 (*en banc*), *cert. denied,* 381 U.S. 935, 85 S.Ct. 1767, 14 L.Ed.2d 700; *United States* v.

history of the statute made it unclear whether Congress intended to encompass bumper stickers in the attribution clause requirement, (2) there had been a "universal practice" among candidates of *not* affixing such clauses to bumper stickers, and (3) the case was the first such prosecution ever brought by the Justice Department. 496 F.2d at 208. We reversed Insco's conviction because he had been "lulled into the reasonable impression" that his actions were not criminal. *Id.* at 209.

Defendants argued that the same reasoning is applicable here. But it is not, for a number of important reasons. First, the finding of a "universal practice" to which Insco's conduct conformed was made after the presentation of evidence by both sides at a trial on the merits before a district judge. Here, only the defense has offered evidence, and that at a pretrial hearing on motions to dismiss the indictment. The Government must be given an opportunity to refute this evidence or to establish that, at the least, defendants' conduct amounted to "reckless disregard of the interest of a bank . . . ." United States v. Wilson, *supra,* 500 F.2d at 720. Additionally, the defendant's total lack of notice was a critical aspect of the decision in *Insco.* The indictment herein, however, alleges that the loan transaction in question was renewed after the issuance of Circular 31, which provided notice of the possible criminal jeopardy of such transactions. Most important, however, is the fact that the Court's action in *Insco* took place after trial, and not before. The decision in *Insco* is authority only for the proposition that, under the facts of that case, it was improper to *convict* Insco. The Court's opinion does not relate to the issue in this case, which is whether the Government may *try* the defendants. This distinction is also applicable to Bouie v. City of Columbia, 378 U.S. 347, 84 S.Ct. 1967, 12 L.E.2d 894 (1964), relied on by defendants. Whatever the merits of an *Insco* defense under the facts of this case, defendants will have an opportunity to raise it at trial. *Cf.* United States v. Pennsylvania Industrial Chemical Corp., 411 U.S. 655, 674-675, 93 S.Ct. 1804, 1816-1817, 36 L.Ed.2d 567 (1973); United States v. Murdock, 290 U.S. 389, 395-396, 54 S.Ct. 223, 225-226, 78 L.Ed. 381 (1933).

Raven, 5 Cir., 1974, 500 F.2d 728, 733 & n. 14, *cert. denied,* 419 U.S. 1124, 95 S.Ct. 809, 42 L.Ed.2d 824 (1975); *United States* v. *Ream,* 5 Cir., 1974, 491 F.2d 1243, 1246, and at this pretrial stage of the present case we hold that "the courts are not to interfere with the free exercise of the discretionary powers of the attorneys of the United States in their control over criminal prosecutions." *United States* v. *Cox, supra,* at 171. In *Newman* v. *United States,* 1967, 127 U.S. App. D.C. 263, 382 F.2d 479, the court held that the decision to prosecute one person rather than another is not reviewable, and that it is not the function of the judiciary to review the exercise of executive discretion in this regard. *Id.* at 482 (Burger, J.)

Moreover, this Court held in *United States* v. *Raven, supra,* a case in which a similar defense was raised, that Raven's argument that his conviction should be set aside because he was singled out as the first subject of a criminal prosecution, despite the presence of numerous other violations of the same criminal statutes by others, was insufficient of itself to require reversal. 500 F.2d at 733.

Defendants' contention that the prosecution here is in bad faith because of selectivity must fall in the fact of these authorities and of the undisputed information furnished by the United States relative to the numerous conferences afforded defendants and their counsel at the highest levels of the Attorney General's office prior to presentation of the matter to the Grand Jury.

Defendants further assert that this prosecution contravenes the public policy of the United States by attempting to regulate private business through criminal prosecutions. It is not for the courts to decide whether a criminal prosecution contravenes some vaguely defined "public policy." Indeed, it has been stated that "public policy favors the unencumbered enforcement of criminal laws . . . ." *United States* v. *St. Regis Paper Co.,* 2 Cir., 1966, 355 F.2d 688, 693. If an indictment sufficiently alleges a violation of the

laws of the United States, and the prosecution of that indictment is not precluded on constitutional grounds, *cf. United States* v. *Laub, supra; Raley* v. *Ohio, supra,* the courts may not dismiss an indictment on grounds of public policy.

Finally, defendants allege that they are denied due process by being subjected to prosecution in this case. Many of the arguments in support of this contention are not properly before us at this stage of the case. Defendants' argument is, in short, that they are innocent and therefore should not be prosecuted. But guilt or innocence is a decision which may properly be reached only after trial on the merits and not before. *Cf. United States* v. *Brown,* 8 Cir., 1973, 481 F.2d 1035, 1041. The indictment was therefore improvidently dismissed and must be reinstated. We emphasize that in reversing the district court and remanding the case for further proceedings, nothing we have said in this opinion is to be construed as intimating any view whatever as to the guilt or innocence of the defendants or as to the case's disposition at trial. We hold only that a Grand Jury having sufficiently alleged in an indictment that defendants conspired to commit a criminal act, and the prosecution not being constitutionally improper, the Government must be given an opportunity to prove its case before the trier of fact.

Reversed.

United States Court of Appeals

FOR THE FIFTH CIRCUIT

OCTOBER TERM, 1974

No. 74-2983

D. C. DOCKET No. CR-73-H-268

UNITED STATES OF AMERICA,
Plaintiff-Appellant,

v.

ROBERT A. MANN AND BANK OF THE SOUTHWEST, NATIONAL ASSOCIATION,
Defendants-Appellees.

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF TEXAS

Before

GIBSON* THORNBERRY AND AINSWORTH
Circuit Judges.

JUDGMENT

This cause came on to be heard on the transcript of the record from the United States District Court for the Southern District of Texas, and was argued by counsel;

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this Court that the judgment of the said District Court in this cause be, and the same is hereby, reversed.

August 7, 1975

Issued as Mandate:

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* Of the Eighth Circuit, sitting by designation.

APPENDIX B

Memorandum and Order of the District Court

United States District Court

SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

CR. NO. 73-H-268

UNITED STATES OF AMERICA

VS.

ROBERT A. MANN, AND
BANK OF THE SOUTHWEST,
NATIONAL ASSOCIATION,
HOUSTON, TEXAS

MEMORANDUM AND ORDER

Based upon the evidence that is not in dispute, and those facts which have been stipulated, and the matters of which the Court can take judicial notice, the Court is of the opinion that the indictment must be dismissed for the following reasons and none other.

Firstly, the Defendants have been denied due process of law.

The Defendants have been denied equal protection of the law.

The indictment fails to state an offense on its face.

The indictment is too vague and indefinite to sustain a prosecution.

18 U.S.C. Sec. 656, as applied in this case, is also too vague and indefinite to sustain a criminal prosecution.

This prosecution is precluded because it violates the ex post facto clause of Section Nine of Article One of the United States Constitution.

The indictment should be dismissed because it is an unlawful retroactive application of government policy as it affects this criminnal prosecution.

Lastly, the indictment must be dismissed because it is against the public policy of the United States to regulate private business by criminal prosecution as was done in this case. The Court is relying upon the *United States of America* v. *Jack P. Ensco,* No. 73-3990, Fifth Circuit, June 21, 1974.

The Court accepts the Defendants' theory of the law as it applies to the above reasons for dismissing the indictment.

For these reasons and for no others, except those stated above, the Court dismisses the indictment.

This is a FINAL JUDGMENT.

SIGNED this 23rd day of July, 1974, at Houston, Texas.

(Signed) WOODROW SEALS
United States District Judge

APPENDIX C

Constitutional Provisions, Statutes and Regulations Involved

(1) Constitutional Provisions

Constitution of the United States, Amendment V

> No person shall be held to answer for a capital, or otherwise infamous crime, unless on a presentment or indictment of a Grand Jury, except in cases arising in the land or naval forces, or in the Militia, when in actual service in time of War or public danger; nor shall any person be subject for the same offence to be twice put in jeopardy of life or limb; nor shall be compelled in any criminal case to be a witness against himself, nor be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation.

(2) Statutes

12 U.S.C. § 371a — Payment of interest on demand deposits

> No member bank shall, directly or indirectly, by any device whatsoever, pay any interest on any deposit which is payable on demand: *Provided,* That nothing herein contained shall be construed as prohibiting the payment of interest in accordance with the terms of any certificate of deposit or other contract entered into in good faith which is in force on the date on which the bank becomes subject to the provisions of this section; but no such certificate of deposit or other contract shall be renewed or extended unless it shall be modified to conform to this section, and every member bank shall take such action as may be necessary to conform to this section as soon as possible consistently with its contractual obligations: *Provided further,* That this section shall not apply to any deposit of such bank which is payable only at an office thereof located outside of

the States of the United States and the District of Columbia: *Provided further,* That until the expiration of two years after August 23, 1935, this section shall not apply (1) to any deposit made by a savings bank as defined in section 264 of this title, or by a mutual savings bank, or (2) to any deposit of public funds made by or on behalf of any State, county, school district, or other subdivision or municipality, or to any deposit of trust funds if the payment of interest with respect to such deposit of public funds or of trust funds is required by State law. So much of existing law as requires the payment of interest with respect to any funds deposited by the United States, by any Territory, District, or possession thereof (including the Phillipine Islands), or by any public instrumentality, agency, or officer of the foregoing, as is inconsistent with provisions of this section and sections 371b, 374, 374a, 461, 462, 462a—1, 462b to 466 of this title is hereby repealed. Dec. 23, 1913, c. 6, § 19 (par.), as added June 16, 1933, c. 89, § 11(b), 48 Stat. 181; and amended Aug. 23, 1935, c. 614, § 324(c), 49 Stat. 714.

18 U.S.C. § 371 — Conspiracy to commit offense or to defraud United States

If two or more persons conspire either to commit any offense against the United States, or to defraud the United States, or any agency thereof in any manner or for any purpose, and one or more of such persons do any act to effect the object of the conspiracy, each shall be fined not more than $10,000 or imprisoned not more than five years, or both.

If, however, the offense, the commission of which is the object of the conspiracy, is a misdemeanor only, the punishment for such conspiracy shall not exceed the maximum punishment provided for such misdemeanor. June 25, 1948, c.645, 62 Stat. 701.

18 U.S.C. § 656 — Theft, embezzlement, or misapplication by bank officer or employee

Whoever, being an officer, director, agent or employee of, or connected in any capacity with any Federal Reserve bank, member bank, national bank or insured bank, or a receiver of a national bank, or any agent or employee of the receiver, or a Federal Reserve Agent, or an agent or employee of a Federal Reserve Agent or of the Board of Governors of the Federal Reserve System, embezzles, abstracts, purloins or willfully misapplies any of the moneys, funds or credits of such bank, or to the custody or care of any such agent, officer, director, employee or receiver, shall be fined not more than $5,000 or imprisoned not more than five years, or both; but if the amount embezzled, abstracted, purloined or misapplied does not exceed $100, he shall be fined not more than $1,000 or imprisoned not more than one year, or both.

As used in this section, the term "national bank" is synonymous with "national banking association"; "member bank" means and includes any national bank, state bank, or bank and trust company which has become a member of one of the Federal Reserve banks; and "insured bank" includes any bank, banking association, trust company, savings bank, or other banking institution, the deposits of which are insured by the Federal Deposit Insurance Corporation. June 25, 1948, c. 645, 62 Stat. 729.

(3) Federal Rules of Criminal Procedure

Rule 12. Pleadings and Motions before Trial; Defense and Objections

(a) Pleadings and Motions. Pleadings in criminal proceedings shall be the indictment and the information, and the pleas of not guilty, guilty and *nolo contendere.* All other pleas, and demurrers and motions to quash are abolished, and defenses and objec-

tions raised before trial which heretofore could have been raised by one or more of them shall be raised only by motion to dismiss or to grant appropriate relief, as provided in these rules.

(b) The Motion Raising Defenses and Objections.

(1) Defenses and Objections Which May Be Raised. Any defense or objection which is capable of determination without the trial of the general issue may be raised before trial by motion.

(2) Defenses and Objections Which Must Be Raised. Defenses and objections based on defects in the institution of the prosecution or in the indictment or information other than that it fails to show jurisdiction in the court or to charge an offense may be raised only by motion before trial. The motion shall include all such defenses and objections then available to the defendant. Failure to present any such defense or objection as herein provided constitutes a waiver thereof, but the court for cause shown may grant relief from the waiver. Lack of jurisdiction or the failure of the indictment or information to charge an offense shall be noticed by the court at any time during the pendency of the proceeding.

(3) Time of Making Motion. The motion shall be made before the plea is entered, but the court may permit it to be made within a reasonable time thereafter.

(4) Hearing on Motion. A motion before trial raising defenses or objections shall be determined before trial unless the court orders that it be deferred for determination at the trial of the general issue. An issue of fact shall be tried by a jury if a jury trial is required under the Constitu-

tion or an act of Congress. All other issues of fact shall be determined by the court.

(4) Regulations or Directives

THE ADMINISTRATOR OF NATIONAL BANKS

WASHINGTON, D.C. 20220

Banking Circular No.31

October 22, 1970

Office of the
Comptroller of the Currency

TO THE PRESIDENTS OF ALL NATIONAL BANKS

SUBJECT: Use of Interbank Deposits as Compensating Balances for Loans to Individuals Connected with Depositing Bank

We have been requested by the Assistant Attorney General in charge of the Criminal Division of the Department of Justice to communicate the following views with respect to the above subject:

"Reference is made to the conversations which representatives of the Criminal Division have had with you and members of your staff concerning the practice of bank officials utilizing the correspondent accounts of their banks for the purpose of compensating lending banks for loans granted to these officials. By using these non-interest bearing correspondent accounts in this manner, some borrowing officials have been able to obtain loans at preferential rates and to circumvent other statutes and administrative regulations promulgated for the protection of Federally regulated or insured banks. Since the borrower maintains these balances as a condition of the loan, he is able to utilize the funds and credits of his bank for his own personal benefit.

Investigation into this area disclosed that this practice is fairly widespread, particularly in certain areas of the country, both in the initial acquisition of a bank and at subsequent times. There are no cases, at the present time, construing this practice as a misapplication under the criminal statutes. We believe, however, that where the facts demonstrate a clear detriment to the bank and a concomitant benefit to its officers this activity would, at a minimum, constitute a breach of the fiduciary duty owed by the officials to the bank and might in certain situations warrant prosecutive action.

In light of the foregoing, your office, together with the Federal Deposit Insurance Corporation, the Federal Reserve Board, and the Federal Home Loan Bank Board, may wish to consider advising the banking industry of our view that the above practices might constitute a violation of Federal criminal statutes."

[illegible] B. Camp
Comptroller of the Currency

APPENDIX D

Orders Issued by the Board of Governors, Federal Reserve System

LOCUST GROVE BANSHARES INCORPORATED, LOCUST GROVE, OKLAHOMA

ORDER APPROVING FORMATION OF BANK HOLDING COMPANY*

Locust Grove Banshares, Incorporated, Locust Grove, Oklahoma, has applied for the Board's approval under § 3(a)(1) of the Bank Holding Company Act (12 U.S.C. 1842 (a)(1)) of formation of a bank holding company through acquisition of 80 per cent of the voting shares of Bank of Locust Grove, Locust Grove, Oklahoma ("Bank").

Notice of the application, affording opportunity for interested persons to submit comments and views, has been given in accordance with § 3(b) of the Act. The time for filing comments and views has expired, and the Board has considered the application and all comments received in light of the factors set forth in § 3(c) of the Act (12 U.S.C. 1842(c)).

Applicant, a non-operating company with no subsidiaries, was organized for the purpose of becoming a bank holding company through the acquisition of Bank ($3.1 million in deposits).[1] Bank is the only bank in Locust Grove (population of slightly more than 1,000), located in northeastern Oklahoma, and is the fourth largest of five banks in Mayes County, the relevant banking market. Bank controls approximately 7 per cent of the total commercial bank deposits in the market. Upon acquisition of Bank, Applicant would control the 367th ranking bank in Oklahoma, holding .04 per cent of the total deposits in commercial banks in

* 60 Federal Reserve Bulletin, October, 1974 at 729.

[1] All banking data are as of June 30, 1973.

the State. Since the purpose of the proposed transaction is to effect a transfer of the ownership of Bank from individuals to corporate ownership with no change in Bank's present management or operation, consummation of the proposal herein would not eliminate existing or potential competition, nor have an adverse effect on other area banks.

A principal of Applicant is also a shareholder, officer, and/or director in two other banks: The Bank of Chelsea, Chelsea, Oklahoma ($5 million in deposits), and First National Bank of Fairlane, Fairlane, Oklahoma ($1 million in deposits). Each of the banks is located over 40 miles distant from Bank and each operates in separate and distinct banking markets from the Mayes County market. From the facts of record, it is the Board's judgment that competitive considerations are consistent with approval of the application.

The financial and managerial resources and future prospects of Applicant, which are dependent upon those of Bank, are considered to be satisfactory. Accordingly, financial and managerial considerations are consistent with approval of the application. As indicated above, the proposed acquisition represents a change in the form of ownership of Bank, and there are no significant proposed changes in the operation or services of Bank. Considerations relating to the convenience and needs of the community to be served are consistent with approval. It is the Board's judgment that the acquisition would be in the public interest and that the application should be approved.

On the basis of the record, the application is approved for the reasons summarized above. The transaction shall not be made (a) before the thirtieth calendar day following the effective date of this Order, or (b) later than three months after the effective date of this Order, unless such period is extended for good cause by the Board, or by the

Federal Reserve Bank of Kansas City pursuant to delegated authority.

By order of the Board of Governors effective September 12, 1974,

Voting for this action: Governors Sheehan, Bucher, Holland, and Wallich. Voting against this action: Vice Chairman Mitchell and Governor Brimmer. Absent and not voting: Chairman Burns.

Board action taken while Governor Brimmer was a Board Member.

(Signed) THEODORE E. ALLISON,
Secretary of the Board.

[SEAL]

DISSENTING STATEMENT OF
GOVERNORS MITCHELL AND BRIMMER

We would deny this application for the reason that we believe it is not in the public interest to sanction an arrangement whereby owners of 80 per cent of the shares of Bank secured a loan to purchase such shares at a preferential rate (5 per cent) on the implicit condition that the lending bank will profit from the transaction by receiving a compensating balance as part of Bank's correspondent account. Thus, Bank's resources are being used to subsidize the personal interests of shareholders owning 80 per cent of Bank.

In our view, if bank stock loans are to be made, they should be made on the same basis as stock collateral loans in general. We are concerned that such preferential loans could result in conflict of interest or breach of fiduciary duty on the part of the borrowing officer or director if the reduction in the interest rate is conditioned on the maintenance of correspondent balances with the lending bank. Accordingly, in our judgment, the Board should not approve this holding company application and thereby sanction the use of such preferential loans.

A further concern of ours, though one which does not appear to be present in the facts of record involved in this case, is that the making of bank stock loans at less than the prevailing interest rate may be a means whereby a lending bank, without the necessity of securing prior Board approval, acquires indirect control of the borrowing bank's shares which are pledged as collateral.

For the foregoing reasons, we would deny the application.

FIRSTBANK HOLDING COMPANY, MARIETTA, OKLAHOMA

ORDER APPROVING FORMATION OF BANK HOLDING COMPANY*

Firstbank Holding Company, Marietta, Oklahoma, has applied for the Board's approval under § 3(a)(1) of the Bank Holding Company Act (12 U.S.C. 1842(a)(1)) of formation of a bank holding company through acquisition of 80 per cent or more of the voting shares of Firstbank of Marietta, Marietta, Oklahoma ("Bank").

Notice of the application, affording opportunity for interested persons to submit comments and views, has been given in accordance with § 3(b) of the Act. The time for filing comments and views has expired, and the Board has considered the application and all comments received in light of the factors set forth in § 3(c) of the Act (12 U.S.C. 1842(c)).

Applicant is a nonoperating corporation organized for the purpose of becoming a bank holding company through acquisition of Bank, deposits of $10 million, representing 0.1 of 1 per cent of the total commercial bank deposits in Oklahoma.[1] Bank is the only bank located in the Love County banking market, which has a population of appro-

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* 61 Federal Reserve Bulletin, February, 1975 at 104.

[1] All banking data are as of December 31, 1973.

ximately 5,600 persons. The proposal represents a corporate reorganization with no change in the management of Bank. Since Applicant has no present operations, consummation of the proposal would have no effect on existing or potential competition.

Accordingly, the Board concludes that competitive considerations are consistent with approval of the application.

The financial condition and managerial resources of Applicant are dependent upon these same conditions as they exist in Bank. Bank's financial condition and management are satisfactory and, based upon Bank's past earnings, the projected dividends from Bank appear sufficient to provide the necessary funds for retirement of the debt that Applicant would incur as a result of this proposal without placing a burden on Bank's capital position. Prospects for Applicant and Bank appear favorable. In addition, the Board notes that Applicant will be assuming a preferential interest rate on certain bank stock loans made to Bank's major shareholders. Although the Board had expressed some concern about such loans in the past, there is no evidence in the record indicating that the loans in this case have resulted in any abuses to Bank or its minority shareholders. Accordingly, considerations relating to the conveniences and needs of the communities to be served are consistent with approval of the application. It is the Board's judgment that the proposed transaction would be in the public interest and that the application should be approved.

On the basis of the record, the application is approved for the reasons summarized above. The transaction shall not be consummated (a) before the thirtieth calendar day following the effective date of this Order or (b) later than three months after the effective date of this Order, unless such period is extended for good cause by the Board, or by the Federal Reserve Bank of Kansas City pursuant to delegated authority.

By order of the Board of Governors, effective January 29, 1975.

Voting for this action: Governors Holland, Wallich, and Coldwell. Voting against this action: Governors Mitchell and Sheehan. Absent and not voting: Chairman Burns and Governor Bucher.

(Signed) THEODORE E. ALLISON,
[SEAL] *Secretary of the Board.*

DISSENTING STATEMENT OF
GOVERNORS MITCHELL AND SHEEHAN

We would deny the application of Firstbank Holding Company to become a bank holding company through acquisition of Firstbank of Marietta ("Bank") based on our view that the interest rate (7 per cent) on certain loans that Applicant will assume as a result of this proposal is preferential. The loans in question were made by Bank's primary correspondent bank, The Liberty National Bank and Trust Company of Oklahoma City, to three principals of Applicant, each of whom pledged their respective shares of Bank's stock as collateral for the indebtedness. Applicant now proposes to acquire approximately 95 percent of the shares of Bank on an even exchange of one share of Applicant for one share of Bank and to assume the existing indebtedness on such shares of Applicant's principals. We are concerned that preferential interest rates on bank stock loans may involve conflicts of interests or a breach of fiduciary duty on the part of the borrowing official if the favorable interest rate is conditioned upon the maintenance of correspondent balances with the lending bank or some other indirect financial advantage to the lender and particularly if such rates are not available on an equivalent basis to all shareholders of the borrowing official's bank. Accordingly, it is our view that the potential evils inherent in the granting and receiving of a preferential interest rate on a bank stock loan indicate that such loans are not in the public interest.

Another ground for denial is our assessment that the proposed acquisition debt to be assumed by Applicant is high in relation to its equity. Applicant is a newly formed corporation and the earnings of Bank would serve as its primary source of funds. The large debt servicing requirements for the purchase of approximately 95 per cent of the stock of Bank could place an undue strain on the financial condition of Bank and impede Bank's ability to provide adequate banking services to the community. In our view, the projected earnings of Applicant (derived from Bank) do not provide Applicant with the necessary financial flexibility to meet its annual debt servicing requirements as well as any unexpected financial needs that might arise at Bank.

For the foregoing reasons, we do not regard the proposal as being in the public interest, and we would deny the application.

NBC CORPORATION,
ALTUS, OKLAHOMA

ORDER APPROVING FORMATION OF
BANK HOLDING COMPANY*

NBC Corporation, Altus, Oklahoma, has applied for the Board's approval under § 3(a)(1) of the Bank Holding Company Act (12. U.S.C. 1842)(a)(1)) of formation of a bank holding company through acquisition of more than 80 per cent of the voting shares of The National Bank of Commerce, Altus, Oklahoma ("Bank").

Notice of the application, affording opportunity for interested persons to submit comments and views, has been given in accordance with § 3(b) of the Act. The time for filing comments and views has expired, and the Board has considered the application and all comments received, including those submitted by the Comptroller of the Currency, in

*61 Federal Reserve Bulletin, February, 1975 at 106.

light of the factors set forth in § 3(c) of the Act (12 U.S.C. 1842(c)).

Applicant is a recently-organized corporation formed for the purpose of becoming a bank holding company through the acquisition of Bank. The proposed transaction essentially involves the transfer of ownership from individuals to a corporation owned by the same individuals with no change in Bank's management or operations. Bank (deposits $15.6 million)[1] is the second largest among six banking organizations competing in its banking market[2], and holds about 28.4 per cent of the market's total commercial deposits. Upon acquisition of Bank, Applicant would control about 0.2 per cent of total commercial bank deposits in the State. Applicant's principal shareholders also control the First State Bank, Grandfield, Oklahoma; however, that bank is located 75 miles southeast of Bank in a separate market area and does not compete with Bank. Since the subject proposal represents merely a restructuring of existing ownership interests, its consummation would not eliminate any existing competition, nor would it appear to have any adverse effects on other banks or on the development of competition in the relevant market. Therefore, competitive considerations are consistent with approval of the application.

The financial condition and managerial resources of Applicant and Bank are considered to be generally satisfactory and the prospects of each appear favorable. The Board notes that the Comptroller of the Currency has expressed some concern that consummation of this proposal may result in a burden upon Bank's earnings. However, on the basis of the Board's review of the financial resources of Bank and Applicant, the Board is of the view that, although Applicant will incur debt in the acquisition of Bank, Applicant appears to be able to service the debt

[1] Deposit data are as of December 31, 1973.

[2] The relevant market is approximated by Jackson County.

without impairing the financial condition of Bank. In addition, it appears that Applicant will be assuming a preferential interest rate on certain bank stock loans made to Bank's major shareholders. Although the Board has expressed some concern about such loans in the past, there is no evidence in the record indicating that the loans in this case have resulted in any abuses to Bank or the minority shareholders. Considerations relating to the banking factors are consistent with approval of the application. Although there will be no immediate change or increase in the services offered by Bank as a result of the shifting of Bank's ownership to a corporation, considerations relating to the convenience and needs of the communities to be served are consistent with approval of the application. It is the Board's judgment that the proposed transaction is consistent with the public interest and that the application should be approved.

On the basis of the record, the application is approved for the reasons summarized above. The transaction shall not be consummated (a) before the thirtieth calendar day following the effective date of this Order or (b) later than three months after the effective date of this Order, unless such period is extended for good cause by the Board, or by the Federal Reserve Bank of Kansas City, pursuant to delegated authority.

By order of the Board of Governors, effective January 23, 1975.

Voting for this action: Chairman Burns and Governors Holland, Wallich, and Coldwell. Voting against this action: Governors Mitchell and Sheehan. Absent and not voting: Governor Bucher.

(Signed) THEODORE E. ALLISON,
Secretary of the Board.

[SEAL]

Dissenting Statement of Governors Mitchell and Sheehan

We would deny the application of NBC Corporation to acquire The National Bank of Commerce ("Bank") since we believe that it is not in the public interest to sanction an arrangement wherein it appears that Bank's resources are being used to subsidize the personal interests of the principal shareholders of Bank. Specifically, the owners of a majority of the shares of Bank, who will also become the majority shareholders of Applicant, secured loans from Liberty National Bank and Trust Company of Oklahoma City, Bank's principal correspondent, at a preferential interest rate.

Under this proposal, Applicant will assume the outstanding indebtedness of Bank's majority shareholders, along with the preferential interest rate, and Bank will continue its correspondent relationship with Liberty National. In our view, such an arrangement could result in a conflict of interest or breach of fiduciary duty on the part of the borrowing officials if the setting of the preferential interest rate, by formal or informal arrangement between the lending bank and Bank, entails Bank assuming a portion of the interest costs of its major stockholders. This could be accomplished by various means, including maintenance by Bank of an inflated correspondent balance at the lending bank, sales by Bank of Federal funds to the lending Bank at below market rates, or placing of certificates of time deposit at below market rates. On the other hand, if such arrangements are not entered into between the lending bank and Bank, the lending bank's stockholders are placed at an obvious disadvantage as a result of their management making loans well below prevailing rates of interest.

Bank stock loans at competitive rates are appropriate as short-term credits, or "bridge loans", while longer term financing of the take-over is being arranged. However, when such credit is for an extended period or, as a result

of renewals, amounts to permanent financing, the basic strength of a local or regional banking system can be weakened. The use of one bank's depositors' funds to make loans which constitute a significant source of another bank's capital dilutes one of the major elements of financial support for the banking system — capital funds which are wholly external to it.

Finally, we are concerned about the sizable debt that Applicant will assume under this proposal. In our view, the debt servicing requirements imposed on Applicant could place an undue strain on Bank's financial condition and thus impair its ability to continue to serve as a viable banking organization in meeting the needs of its community.

For the foregoing reasons, we would deny the application.

Supreme Court, U. S.
FILED
JAN 7 1976
MICHAEL RODAK, JR., CLERK

No. 75-619

In the Supreme Court of the United States

OCTOBER TERM, 1975

ROBERT A. MANN AND BANK OF THE SOUTHWEST, NATIONAL ASSOCIATION, PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

ROBERT H. BORK,
Solicitor General,
Department of Justice,
Washington, D.C. 20530.

In the Supreme Court of the United States

OCTOBER TERM, 1975

No. 75-619

ROBERT A. MANN AND BANK OF THE SOUTHWEST, NATIONAL ASSOCIATION, PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

Petitioners contend that the acts charged in the indictment do not constitute a conspiracy to misapply bank funds in violation of 18 U.S.C. 371 and 656, and that the government misled them into believing that their conduct was proper.

An indictment filed in the United States District Court for the Southern District of Texas charged petitioner Robert A. Mann, Chairman of the Board of Directors and Chief Executive Officer of the First National Bank of Waco, Texas ("Waco Bank"), and petitioner Bank of the Southwest, National Association, of Houston, Texas, with conspiring from December 1969 until February 1972 knowingly and willfully to misapply funds of the Waco Bank with intent to injure and defraud the Waco Bank, by

causing its funds to be converted to the use, benefit, and advantage of Mann, in violation of 18 U.S.C. 371 and 656.[1] More particularly, the indictment charged a scheme whereby Mann borrowed $6,900,000 from the Bank of the Southwest to purchase a controlling interest in the Waco Bank.[2] Bank of the Southwest charged Mann only 3 percent interest on his loan, although at that time the bank's prime rate was 8½ percent. In return for this preferential rate, Bank of Southwest required Mann to cause funds of the Waco Bank, in an amount equal to the unpaid principal, to be placed in a non-interest bearing account at Bank of the Southwest.[3] The indictment alleged that these funds of the Waco Bank thereby were converted to Mann's use and benefit, since the granting of the 3 percent preferential interest rate would save Mann approximately $350,000 in interest charges per year.[4]

In response to petitioners' pre-trial motions to dismiss the indictment, the district court held an evidentiary hearing and on July 23, 1974, issued a Memorandum and Order dismissing the indictment (Pet. App. B); the court of appeals reversed (Pet. App. A).

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[1]The full text of the indictment is reprinted in a footnote to the court of appeals' opinion (Pet. App. A-3—A-6, n. 1).

[2]Bank of the Southwest was to fund $4,000,000 of this amount, with the remaining $2,900,000 to be raised by Republic National Bank.

[3]The bill of particulars specified that these funds of the Waco Bank were to be deposited in a demand account in the name of the Waco Bank (see Pet. 5-8, n. 2).

[4]The indictment further alleged that Mann was to reduce the unpaid balance of his loan to $3,000,000, and at the same time the amount of the Waco Bank funds on deposit in the demand account at the Bank of the Southwest would be reduced to $3,000,000. Mann then was to pay 4 percent interest on the remaining balance of his loan, and at that preferential rate, Mann would save approximately $110,000 in interest charges per year.

1. This petition challenges the court of appeals' conclusion that the pre-trial motion to dismiss should have been denied. It thus comes at an interlocutory stage of the proceedings, seeking to bring the case here before the record is fully developed at trial. Since the questions petitioners seek to have this Court now review can be considered after a trial on the merits, and, if petitioners are acquitted, need not be considered by this Court at all, there is no present need for review by this Court, even if the issues presented might otherwise warrant further review, which we believe they do not.

2. Petitioners contend that the indictment, as "clarified" by the bill of particulars, fails to make out a conspiracy willfully to misapply bank funds, in violation of 18 U.S.C. 371 and 656. It is their theory that Waco Bank's retention of legal title to the funds on deposit in the Bank of the Southwest precludes a showing that the funds were converted, which they contend is a necessary element of the offense defined in 18 U.S.C. 656 (Pet. 15). We think it clear that when a bank officer commits millions of dollars of bank funds to a use from which he derives extensive personal benefit with little or no benefit to the bank, there has been a criminal misapplication of the bank's funds.

In any event, in this case there was a conversion despite the Waco Bank's retention of legal title to the funds. The maintenance of the account at the Bank of the Southwest deprived the Waco Bank of the actual possession of its money. See *United States* v. *Brookshire,* 514 F.2d 786 (C.A. 10); cf. *Pan American Petroleum Corp.* v. *Long,* 340 F.2d 211, 219-221 (C.A. 5), certiorari denied, *sub nom. Southwestern Life Insurance Co.* v. *Pan American Petroleum Corp.,* 381 U.S. 926. Additionally, petitioners' agreement to maintain the Waco Bank's account at levels corresponding to the unpaid balance of Mann's personal loan deprived the Waco Bank of its right to unfettered control of its own funds while Mann's loan remained unpaid. The

Waco Bank thereby was prevented from exercising the right to use its own funds for its own benefit—for example, by depositing those funds in an interest bearing account. This interference with the Waco Bank's enjoyment and use of its own money constituted a classic instance of conversion. See *United States* v. *Brookshire, supra;* cf. *A. C. Rent-A-Car, Inc.* v. *American Nat. Bank & Trust Co.*, 339 F. Supp. 506, 511 (S.D. Ala.), affirmed *per curiam*, 477 F.2d 564 (C.A. 5); *Veeco Instruments, Inc.* v. *Candido*, 70 Misc. 2d 333, 334 N.Y. Supp. 2d 321 (N.Y. Sup. Ct.).

3. Petitioners argue further that they were not given fair notice that their conduct was criminal because the government misled them into believing that their activities were proper (Pet. 18-23). But this claim amounts to an assertion that there was no willful misapplication of funds; it is thus an issue for resolution at trial, not a proper basis for dismissal of an indictment under Rule 12, Fed. R. Crim. P. See *United States* v. *Knox*, 396 U.S. 77, 83 n. 7.[5]

In any event, the government did not mislead petitioners into believing that their loan scheme was proper. Petitioners' argument rests primarily on a confusion between government support for the traditional and legitimate use of a compensating balance (where the borrower is required to maintain an account with the lending bank corresponding to the size of his loan) as government approval for the improper use of a compensating balance (where a third party—here, the Waco Bank—which receives no benefit from a loan, is required to maintain the corresponding balance with the lending bank).

It is true that in 1970, in a letter to a Senate committee, the Antitrust Division of the Department of Justice urged Congress not to outlaw the traditional use of compensating balances. 116 Cong. Rec. 32125-32126 (1970). Similar

[5]For example, with regard to the issue of willfulness, we are advised that the government's evidence at trial will show deliberate efforts by petitioner Mann to conceal critical aspects of these transactions from bank auditors.

views were expressed in letters to Congress by officials of the Department of the Treasury and the Federal Reserve Board, and in a report by the Senate Committee on Banking and Currency. *Id.* at 32124-32129; S. Rep. No. 91-1084, 91st Cong., 2d Sess. 17 (1970). A reading of these letters and the Senate report shows, however, that approval was expressed solely for the traditional use of compensating balances. There have been no government pronouncements approving the type of compensating balance loan employed by petitioners. Indeed, that type of scheme was specifically disapproved in Banking Circular No. 31 (Pet. App. C-6), which was circulated to the banking community in October 1970. The misapplication of funds charged in the indictment continued after this date; in fact, the preferential loan was renewed thereafter.[6]

Under these circumstances, petitioners' reliance on *United States* v. *Laub*, 385 U.S. 475; *Bouie* v. *City of Columbia*, 378 U.S. 347; and *Raley* v. *Ohio*, 360 U.S. 423, is misplaced.[7] In those cases, this Court held that the

[6]We are unable to discern the basis for petitioners' assertion (Pet. 22) that this Court's decision in *Coffin* v. *United States*, 156 U.S. 432, precludes reliance on the renewals of the loans as constituting misapplication of the bank funds. *Coffin* does not discuss renewals of improper loans; it holds first that the refusal to instruct concerning the presumption of innocence and the instructions given concerning the burden of proof were error, and second that the offense of making a false entry is not committed where the transaction entered, through improper, actually occurred. 156 U.S. at 463.

[7]Petitioners also mistakenly rely on *United States* v. *Insco*, 496 F.2d 204 (C.A. 5), where the court reversed a conviction for conduct which had been shown at trial to have been generally accepted as proper. Their allegations in this regard amount to a contention that their actions were not willful, a controverted issue that is to be decided by the finder of fact after trial. As the court below noted (Pet. App. A-18, n. 7):

> * * * The decision in *Insco* is authority only for the proposition that, under the facts of that case, it was improper to *convict* Insco. The Court's opinion does not relate to the issue in this

government may not prosecute a citizen after actively misleading him by authoritative assurances that his conduct was proper: here, the government gave no such assurances.[8]

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case, which is whether the Government may *try* the defendants. This distinction is also applicable to *Bouie* v. *City of Columbia*, 378 U.S. 347, 84 S.Ct. 1967, 12 L.E.2d 894 (1964), relied on by defendants. Whatever the merits of an *Insco* defense under the facts of this case, defendants will have an opportunity to raise it at trial. *Cf. United States* v. *Pennsylvania Industrial Chemical Corp.*, 411 U.S. 655, 674-675, 93 S.Ct. 1804, 1816-1817, 36 L.Ed.2d 567 (1973); *United States* v. *Murdock*, 290 U.S. 389, 395-396, 54 S.Ct. 223, 225-226, 78 L.Ed. 381 (1933).

[8]Petitioners cite a letter written on May 4, 1971, by the then Chief of the Fraud Section of the Criminal Division of the Department of Justice (Pet. 13) and one written on March 21, 1973, by the Office of the Comptroller of the Currency, expressing reservations about the wisdom or feasibility of initiating prosecutions for the making of compensating balance loans of the type employed by petitioners, where the loans were made before the issuance date of Circular 31. These letters, however, did not imply that this type of compensating balance loan was a proper banking arrangement, nor that particularly egregious transactions or loans renewed after October 1970 should not be prosecuted.

Moreover, it is the prerogative of the executive to initiate criminal proceedings, and courts should not "interfere with the free exercise of the discretionary powers of the attorneys of the United States in their control over criminal prosecutions." *United States* v. *Cox*, 342 F.2d 167, 171 (C.A. 5), certiorari denied *sub nom. Cox* v. *Hauberg*, 381 U.S. 935.

Petitioners also refer to recent actions by the Board of Governors of the Federal Reserve System approving the formation of bank holding companies to acquire certain banks, which, they contend, indicate the Board's approval of the type of transaction involved here (Pet. 23-24; Pet. App. D-1—D-11). These actions, occurring in September 1974 and thereafter, could hardly have motivated petitioners' conduct between December 1969 and February 1972, the dates of the charged conspiracy. In any event, petitioners rely upon the characterization of the approved transaction by the dissenting members of the Federal Reserve Board. The Assistant Secretary of the Federal Reserve Board has informed us that it is not the policy of the Federal Reserve System to approve compensating balance loans of the type involved here, and the dissents in the cases upon which petitioners rely reflect simply disagreements concerning the analysis of the facts involved in those cases. The full text of the Assistant Secretary's response to our inquiry concerning these cases is contained in the government's reply brief in the court below, a copy of which we are lodging with the Clerk of this Court.

4. Petitioners assert that the court of appeals improperly concluded that petitioners' defense of lack of notice should be considered at trial, rather than on a pre-trial motion under Rule 12, Fed. R. Crim. P. They cite *Laub, supra,* in support of their claim (Pet. 26-27). *Laub* involved a charged violation of 8 U.S.C. 1185(b). In concluding that the acts charged in the indictment did not constitute a violation of that statute, and thus that the indictment was properly dismissed, this Court rested its decision "entirely upon our construction of the relevant statutes and regulations" (385 U.S. at 477). Here, the construction of the relevant statutes and regulations leads to no such conclusion. Petitioners argue instead that they are entitled to acquittal since *they* so construed the statute. This, as the court below correctly concluded, is a defense going solely to the issue of intent, and thus properly is a matter for consideration on the trial of the general issue.[9]

It is therefore respectfully submitted that the petition for a writ of certiorari should be denied.

ROBERT H. BORK,
Solicitor General.

JANUARY 1976.

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[9]*United States* v. *Covington*, 395 U.S. 57, on which petitioners also rely, is not to the contrary. That case holds that a defense of self-incrimination to a Marihuana Tax Act prosecution may often be a defense "capable of determination without the trial of the general issue" (*id.* at 60) and thus appropriate for resolution on a pre-trial motion under Rule 12, Fed. R. Crim. P. In contrast, a defense going to whether or not petitioners acted willfully is directly related to the trial of the general issue—whether there was a willful misapplication of bank funds.

Supreme Court, U. S.
FILED
JAN 15 1976
MICHAEL RODAK, JR., CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1975

No. 75-619

ROBERT A. MANN AND BANK OF THE SOUTHWEST, NATIONAL ASSOCIATION, *Petitioners*

v.

UNITED STATES OF AMERICA, *Respondent*

PETITIONERS' REPLY TO MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

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Petitioners file this brief Reply to point out to the Court that the Solicitor General's Memorandum opposing Petitioners' request for certiorari, although filed out of time, nevertheless, is not only a meager document, but, most importantly, advances arguments which are novel enough, standing alone, to entitle Petitioners to a review by certiorari.

The Solicitor's arguments reflect the urgent need for this Court to more thoroughly review this case.

1. The first argument of the Solicitor [1] is the often-used position of the Justice Department that we should all wait awhile until presumptively innocent people stand an undoubtedly expensive trial. This demurrer completely misses the point of this appeal. The Gov-

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[1] Page 3, Solicitor's *Memorandum in Opposition*.

ernment's novel theory of prosecution has been challenged by proper motion raising serious threshold constitutional issues in a criminal case of major import to the nation's banking industry. The Petitioners should not have to wait the many months or years involved to again come back to this Honorable Court. The record is well documented and provides ample grounds for this Court to review the Motion to Dismiss now.

2. Secondly, the Solicitor opposes the granting of certiorari by advancing the novel argument that even though a bank *maintains legal title to its funds,* and even though such funds are kept in *its own account,* that the indictment, as clarified by the bill of particulars, is legally sufficient to charge the crime of conversion.[2] The fundamental novelty of this argument desperately needs review now. The import of this novel argument on the banking industry in the maintenance of the widespread practice of compensating balances and the placing of bank funds in their own bank accounts is obvious. Until the Government issued Circular No. 31, the practice was *never* challenged. To this day, no one knows the circumstances under which such practice is permissible.

Additionally, the Solicitor, in an attempt to show some detriment to the Waco bank, gratuitously argues, for the first time, that the Waco bank was prevented from exercising its right to draw interest on its own account at the Bank of the Southwest. There is not now, nor has there ever been, a criminal case holding that a national bank is required to choose how much money it will maintain in demand accounts (non-interest bearing, as here) or time accounts (interest bearing). Indeed, the fatal defect in the entire case is that the Waco bank was not only legally free to place some of its funds in demand accounts, but, also, that federal law expressly *prohibits* the payment of interest to the Waco bank on demand account funds [12 U.S.C. 371 (a)].

[2] Pages 3 and 4, Solicitor's *Memorandum in Opposition.*

In effect, the very simple and novel argument of the Solicitor is that this indictment indirectly seeks to compel a national bank to draw interest on funds even though the bank must have funds in a demand account to be able to honor its customers' business needs. These judgments have traditionally been left to the banks to determine, but *never* have they formed the basis of a criminal indictment.

3. Thirdly, the Solicitor attempts to reduce Petitioners' substantial "fair notice" argument to an argument that there was no willful misapplication of funds.[3] The "fair notice" argument cannot be dealt with in such cavalier fashion. The Solicitor does not understand the basic argument of Petitioners which is that the Government failed to give Petitioners fair notice that their alleged actions might constitute conversion of bank funds, willful or otherwise. Nevertheless, the Solicitor attempts to erroneously emphasize that Petitioners are simply arguing that their acts were not criminally willful and thus draw the conclusion that because the element of willfulness is for the jury, the review by certiorari should not be granted. The jury issue of willfulness has nothing to do with Petitioners' appeal. The issue is whether the Government gave Petitioners fair notice that their acts might constitute the

[3] Page 4, Solicitor's *Memorandum in Opposition.*

crime of conversion, or by their conduct led Petitioners to believe the loan was not illegal. This issue was properly raised under Rule 12, Fed. R. Crim. P., and is most appropriately before this Court for review.

The Government attempts *for the first time* to now draw a distinction between "traditional" uses of compensating balances and other uses which the Government now seeks to prohibit.[4] It is unfortunate that such distinctions now rather crudely sought to be drawn by the Government were not in existence at the time the loan in question was made over six years ago. The Solicitor's argument that Circular No. 31 warned against such practice as here sought to be punished splendidly overlooks the fact that Circular No. 31 was issued *after* the loan was made.

Even so, the Government's belated effort to even now attempt to define what practices are prohibited merely accentuates the strength of the "fair notice" argument of Petitioners.[5]

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[4] Pages 4 and 5, Solicitor's *Memorandum in Opposition.*

[5] The Government states at page 4 of its *Memorandum in Opposition* that the lending practice sought to be prohibited here is distinguished from "traditional" lending practices by the fact that a *third party,* such as the Waco bank, supplied the compensating balance, rather than the borrower himself. Petitioner has already directed this Court's attention to *The Antitrust Implications of Compensating Balances,* 58 Va.L.Rev. 1 (1972). This article reflects at page 3:

> "An increasingly popular means of satisfying the requirement [compensating balance] is through "link" financing, where the borrower arranges with a *third party,* typically an insurance company, mutual fund or pension fund, to supply the lender with the compensating deposit balance." (Brackets and emphasis added.)

Thus, the Government's attempt here to draw a distinction based on the fact that a *third party* supplied the funds for the compensating balance rather than the borrower himself is without merit. That practice was also popular and prevalent in the industry as of the date of the article in January, 1972, *six months before Petitioners were indicted* in June, 1972. Pension funds and mutual funds inherently involve the exercise of fiduciary duties with money similar to a bank, but apparently, the Justice Department, by waiting to this late date to hastily attempt to define the distinction between "traditional" practices and non-traditional practices, could not cover every loophole in their thesis. Hopefully, crimes will not be created by definitions of conduct sought by the prosecution in a brief, but by Congress or duly implemented regulations with fair notice to those affected.

Finally, the Solicitor contends that, in any event, the loan was *renewed* after Circular No. 31, and the indictment is therefore sufficient as charging the offense of misapplication after Circular No. 31 was issued. This argument is unsupported by any case. In fact, this Court has clearly held that *renewals* do not constitute a misapplication offense. *Coffin* v. *United States,* 162 U.S. 664,16 S.Ct. 943, at pp948-949, 40 L.Ed. 1109.[6]

4. The Solicitor's final argument again misses the point of this appeal. The Solicitor attempts, hopefully by now quite fruitlessly, that the fair notice defense is really Petitioners' way of stating the acts were not willful. In conclusion, the issue is whether the indictment, based on this new and novel combination of alleged acts, legally charges the crime of conversion.[7]

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[6] Petitioners respectfully apologize to the Court and the Solicitor regarding the earlier citation to *Coffin* v. *United States* whereby Petitioners cited 15 U.S. 432, 15 S.Ct. 394. This citation was to an earlier *Coffin* decision, but was not the opinion containing the principle cited here.

[7] The Solicitor's *Memorandum in Opposition* did not respond to the fact that the indictment was based on a conspiracy, not a substantive violation of 18 U.S.C. 656. Thus, the basic issue should be whether the alleged agreement was unlawful when made in December, 1969. Obviously, if the object of the conspiracy was

It is therefore respectfully prayed that the Petition for Writ of Certiorari be granted as is so earnestly needed.

Respectfully submitted,

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not unlawful at the time the alleged agreement took place, then the alleged unlawful conspiracy will not stand.

The fact that this is a conspiracy indictment highlights the need for review because the Government has sought to pick and choose among overt acts without any proof of what the essential operative facts are that give this case the characteristics of criminality.